GSM CONSULTING PTY LTD
13 The Greenway
Elanora Heights NSW 2101
Phone: (02) 9913-9321 Fax: (02) 9970-6464
Email: gstearn@triode.net.au
ABN: 86 137 744 702

27th May 2010

Economics Legislation Committee
Department of The Senate
PO Box 6100
Parliament House ACT 2600
Email: economics.sen@aph.gov.au

Dear Sirs

Please find attached a submission to The Senate Standing Committee on the Economics Enquiry into the Tax Laws Amendment (Research & Development) Bill 2010 and Income Tax Rates Amendment (Research & Development) Bill 2010.

Yours sincerely,

Geoff Stearn
Managing Director
GSM CONSULTING PTY LTD

GSM CONSULTING PTY LTD
13 The Greenway
Elanora Heights NSW 2101
Phone: (02) 9913-9321 Fax: (02) 9970-6464
Email: gstearn@triode.net.au
ABN: 86 137 744 702

SUBMISSION TO THE SENATE COMMITTEE ENQUIRY INTO THE R&D TAX CREDIT DRAFT LEGISLATION

We have worked with the R&D Tax Concession since its inception in 1985. At that time, the introduction of the 150% Tax Concession was, in practical terms, to encourage industry to do its own experimentation rather than rely on overseas development. It encouraged companies to develop new products and technologies as well as exploit and expand technology initially developed overseas.

In the light of our experience over those 25 years, we have made submissions in regard to the recent consultation paper (October 2009) as well as the first and second exposure draft stages (in January 2010 and April 2010) for the proposed new R&D Legislation.

Despite the changes made to those exposure drafts in the proposed and revised Legislation, our concerns expressed in those submissions remain at this time. The proposed Legislation remains impractical and unsuited to business or industrial R&D and is far too complex. The problems appear to stem from a lack of involvement with industry in the first instance and then lack of time in which to respond, particularly in the latter parts of the process.

It would appear that in the new Legislation there is a desire to cut costs rather than encourage innovation and growth in industry. As a result, the current proposals are likely to result in discouraging R&D in Australia rather than encouraging innovation in Australia. The proposals seem to seek a short term gain to Government coffers through cost reduction but result in long term pain and reduction in wealth in Australia.

There are apparently concerns in Canberra that the Legislation might support normal business activities which would be undertaken irrespective of the R&D Government support. In practice it may be that R&D activities will be undertaken anyway but with the proposed Legislation, unfortunately many of them will not be undertaken in Australia.

The proposals stem from the Cutler Report which seemed to recommend the support of the iconic R&D Tax Concession with increased support levels for SME's. It was also proposed to change from a tax deduction to a tax credit and cut out the 175% premium. The Cutler report proposed "a less complex and more predictable support mechanism" The proposed Legislation of May 2010 does not meet these objectives and will create a situation which will be more complex and less predictable for companies rather than the reverse. The proposed wholesale changes to the R&D Tax Concession appear to stem from the comments in the Cutler Report that "appropriate measures be taken to heavily constrain whole of mine and similar claims". We have no knowledge of any such claims, thus cannot comment on them. Nevertheless, those aims could surely be achieved in a much simpler manner than by a wholesale change to the R&D Tax Concession and without the major increase in complexity currently proposed.

Much is made of the support for SME's by an increase in support levels to the equivalent of 150% Tax Concession. However, this is meaningless since the complexity and uncertainty in the definitions mean it would be impractical for many SME's to seek support through the new proposed Legislation. The level of support is immaterial if it cannot be applied to anything. A more generous incentive such as 250% could easily be used without any depletion of Government coffers since 150% or 250% of nothing remains nothing.

The proposed wholesale changes to the R&D support will create uncertainty and detract from investments in risky R&D in Australia in both large and small companies.

There are a number of areas in which the proposed legislation can create problems and which is far removed from the thrust of the Cutler Report. We have remarked on a number of these in our previous submissions and will not repeat them in full now. However, they include:

- Definition of R&D – the new revised definition still remains far too similar to the previous proposals of December 09 and March 10 for "innovation <u>AND</u> technical risk" rather than the existing definition of "innovation <u>OR</u> technical risk".
- The complex definitions of core and supporting activities will create huge levels of uncertainty.
- The "dominant purpose" and the definition of supporting activities can only lead to enormous uncertainties.
- Feedstock, has always needed proper definition and this is still the case. If it is to be included in the legislation it must be clear that it is restricted to the direct inputs associated with material fed into the existing prototype to test out the effectiveness of such prototype. It does not apply to the material used to produce the prototype.
- The apparent need for the costing of activities which is totally impractical and uneconomic, particularly for SME's and even for quite large companies.
- The innovation being new to the world rather than new to the company. This is particularly onerous when companies do not know what has been undertaken elsewhere in the world and cannot find out as the information is considered proprietary. If implemented this would also discourage companies from expanding and further developing technologies initially developed overseas which was one of the aims set out in 1985.

All of the above are detrimental to the support of commercial R&D in industry as opposed to R&D carried out in laboratory environments.

In the light of the above, we propose that the Government maintains the existing Legislation in place at the 2008/9 year and make minor changes to that Legislation in line with the suggestions made in the Cutler Report rather than seek to make major changes to the whole thrust to the support for R&D.

Along those lines, we suggest the following small changes to the existing R&D Tax concession be implemented:

- In July 2010, to increase the level of support to SME's to 150% Tax Concession and to other companies to 133% Tax Concession while removing the 175% premium. Also, to increase the access to the cash-back to companies with turnover up to $20 million.

- In July 2011, change the Legislation from one of a Tax Concession to a Tax Credit. Also, replace the concept of activities in the Act to those based around a project which is much more suitable and practical for comprehension of those in industry, particularly for SME's.
- Along with these, if there is a necessity to implement Legislation to prevent whole of mine claims, that that be implemented in July 2011 in an appropriate specific targeted and concise manner, in which it is made clear that it applies <u>ONLY</u> to a small number of situations.

The above proposals would avoid the need for large amounts of supporting material and guidance material to be defined before the Act can be implemented. It would also provide a much higher level of certainty in the industry concerning the direction of R&D. It might also encourage further investment in R&D in Australia at a time when many companies are suffering from the adverse effects of the global financial crisis.

Geoff Stearn
Managing Director
GSM CONSULTING PTY LTD