ADITUS CONSULTING

26 May 2010

Mr John Hawkins
Committee Secretary
Senate Standing Committee on Economics
Parliament House
Canberra ACT 2600

Dear Sir

Senate Standing Committee on Economics Inquiry

Tax Laws Amendment (Research and Development) Bill 2010 and Income Tax Rates Amendment (Research and Development) Bill 2010

Aditus Consulting Pty Ltd is a small consulting firm specialising in the provision of R&D tax advice to a wide range of clients numbering less than 50 companies and ranging from small clients accessing the R&D offset scheme to larger clients accessing the 125%/175% R&D tax concession.

I have seen the current R&D tax concession evolve from an immature position where everything was a potential R&D project to the current position with a more refined understanding of the nature and scope of what constitutes eligible R&D activities. This is ably supported by a body of case law, Guidelines, Tax Rulings, Interpretative Decisions and the recently consolidated 125% R&D Tax Guide to Benefits. The scheme works effectively in actively supporting R&D across all sectors of the economy and the various stakeholders generally work within the well accepted and understood rules of the system.

I have worked in both large accounting firms and small advisory firms. I can say that I have never seen or advised on a “whole of mine” claim or other such ambit claims in my 20 years. It troubles me that the justification for introducing this new scheme is to avoid the incidence of these claims happening. I would like to see specific evidence of these claims, the years of income in question and an explanation as to why they passed both AusIndustry’s internal eligibility review processes and also the ATO’s scrutiny, to determine whether this is just spin.

Generally, we support the broad aim of the introduction of a more streamlined tax incentive however, after a review of the Bill and Explanatory Memorandum; the proposed changes are in direct opposition to the stated policy objective.

Senator Carr excitedly states that “The new scheme will stimulate more of Australia’s two million businesses to undertake research and development rather than just the 8,000 that benefit from the current concession”. I want him on my marketing team because I don’t know for the life of me where these clients are coming from. In 25 years of operation and countless millions of dollars spent on promotion by the Government on the scheme and *very active* marketing by those working in the “industry”, we have a total of 8000 claimants nationwide (with some of those claimants having a number of subsidiary companies).

Almost every practitioner in this area has stated that the size of their practices will decrease both in revenue and in the number of clients who will make a claim. So just where is the increase in the SME market coming from?

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Senator Carr also states that "This legislation follows an independent review of the national innovation system, and almost a year of consultation with key stakeholders". That is true but interestingly, as I sit here drafting my response, I can use most of the material I submitted in October 2009 and February 2010 as not many of the perceived flaws with the proposed scheme have altered with the introduction of this Bill. It does make me wonder whether any of these submissions are actually read in earnest or whether the submissions are all cast in the same light of whingeing consultants protecting their revenue streams and the "big end of town" complaining.

This is certainly the impression I gained from reading the Committee Transcripts earlier this week. The beauty of this Bill however is that it doesn't do any favours for anyone except of course if you are a pure research company operating in a laboratory, in Australia, without running any production trials because all the trials have failed at the laboratory stage. Isn't this where we were in 1985?

And the start date is 1 July 2010. There are no guidelines, no forms, no regulations, no ATO interpretations/rulings on how to calculate the notional deduction and no industry based briefing sessions have been held. How can businesses be expected to "gear up" and advisors proceed with any certainty? This is nothing but policy making on the run.

We have major concerns with the Bill both at a policy level and on more practical terms.

- For a large number of companies, the increased compliance costs to initially implement the proposed changes together with the ongoing maintenance, will outstrip the cost benefit of the incentive offered and many will not bother to make a claim.

- The proposed changes are definitionally complex and unwieldy to implement. The splitting of R&D activities into core and supporting together with the restrictions around core activities in terms of "experimental activities" and "new knowledge" will add uncertainty and administrative complexity both at the taxpayer level and a scheme administration level. It has never been successful in all the years since the inception of the 150% R&D tax concession to split a project like this.

- The definitions lack clarity and often rely on a subjective assessment of whether a taxpayer has met the relevant tests, of which there are many.

- There are inconsistencies in explanations provided in the EM compared to the draft version of the relevant provision rendering the examples unworkable.

- There are limited transitional provisions.

- There are no draft regulations outlining how the two administering bodies would like the information to be presented.

- There is no discretion in place for AusIndustry or the ATO to consider issues that fall within the current legislation and from 1 July 2010, will fall out of the new scheme.

- The timing of advance findings is dependent on making a Committee meeting sometime in the future and not from the date of lodgement as is the current case with overseas certificates.

- The dominant purpose test imports a test that is subjective, and is heavily dependent on a strong working knowledge of existing tax case law that is generally not within the reach of engineers and technical personnel undertaking the R&D. The decision will invariably fall

back to a company's in house tax team or external advisors to determine. This test will need to be applied for every supporting activity. Complexity and added compliance costs.

- Supporting activities are integrally linked to the carriage of a successful R&D project but not all supporting activities are carried out for **the** dominant purpose of the R&D. This proposed change will eliminate any associated costs or "eligible apportionable expenses" where it cannot be demonstrated that the activity was undertaken for the dominant purpose of the core R&D.

- The operation of the dominant purpose test and the new feedstock provisions combine to render most legitimate, production-based R&D ineligible.

Conclusion

Please don't sacrifice a well oiled, broad based industrial R&D scheme for a scheme that is poorly defined, unduly complicated and favours research companies over industrial based companies. Policy making on the run does not work. More time is needed to introduce effective legislation that can deliver on the stated policy objectives. From the limited modelling I have seen, by simply repealing the 175% incremental deduction should go a long way to making the current scheme more revenue neutral.

Please read the submissions of the many consultants, companies and industry bodies who comprise and advise the R&D sector. It is not all self interest.

Yours sincerely

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