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Senator Annette Hurley
Chair of the Economics Legislation Committee Inquiry

28 May 2010

Dear Senator Hurley

Re: Senate Economics Legislation Committee inquiry on the *Taxation Laws Amendment (Research and Development) Bill 2010*

Please find attached our written submission to this inquiry. This is to be read in conjunction with the evidence presented at the inquiry in Sydney on Friday 21 May.

Please do not hesitate to contact me on 03 9671 7376 should you require further clarification.

Yours sincerely

Serg Duchini
Director, Deloitte Touche Tohmatsu Ltd

Deloitte welcomes the opportunity to make a written submission to the Senate Economics Committee inquiry on the *Taxation Laws Amendment (Research and Development) Bill 2010*. This submission is to be read in context of the oral presentation made by Sergio Duchini, Deloitte national R&D & Tax Services Practice leader to the Committee in Sydney on Friday 21 May 2010.

Background

As a firm Deloitte has always taken a positive and active role in the ongoing development of Australian innovation policy, making submissions to all major reviews and appearing before previous House of Representatives and Senate inquiries. We are always objective, considered and measured in our approach to this debate.

In the development of this Bill we have been very active since Senator Carr announced on 22 January 2008 that the review of the National Innovation System included in its terms of reference the consideration of the appropriateness, effectiveness and efficiency of the R&D tax concession scheme in promoting innovation.

We made submissions to the Cutler review, engaged in the public and private consultation process following the release of the Treasury Consultation paper in September 2009, made a detailed submission on the first exposure draft released on 18 December 2009, engaged directly with Treasury and the Department of Innovation, Industry, Science and Research (Innovation Department) on subsequent consultations, both public and private, and made further submissions on specific issues leading up to the release of the second exposure draft on 31 March 2010. Following its release, we engaged in further consultation with Treasury and the Innovation Department and subsequently made a further and final submission on the second exposure draft.

There are many positive aspects of this Bill that we wish to highlight:

- The introduction of a tax offset/credit that is refundable is certain circumstances. This is a positive improvement to an outdated super deduction
- The increase in base rate of support to 10% for large claimants and 15% for SMEs is welcomed
- The removal of the expenditure limit for SMEs – a dramatic improvement
- The removal of the 175% incremental concession, which was complex and almost impossible to model in advance in most corporate groups, is good policy
- Aligning the review time limits with other taxes to four years is long overdue and is welcomed
- The expansion of foreign-owned R&D to include permanent establishments is a good move
- Increasing the base level support for foreign-owned R&D to 10% and removing the incremental nature of the benefit is good policy
- The improved criteria for undertaking R&D offshore in certain circumstances with a lifting of the expenditure threshold from 10% to 50% is welcomed, and is very positive for certain industries that are forced to conduct elements of core R&D offshore
- The lifting of the tax-exempt ownership threshold from 25% to 50% is an improvement and is welcomed
- The removal of the multiple sale test for software R&D has eliminated an outdated, discriminatory requirement and the new exclusions reflect a modern economy and current business model for the development and exploitation of software better
- The expansion of the role and powers of Innovation Australia, if executed appropriately, should give claimants greater certainty in future, although a rocky start is likely, given the compressed timeframes being sought for this Bill's implementation.

These are all positive improvements compared with the existing R&D tax concession and we welcome them.

There are, however, several concerning implications that flow from a number of the core provisions of the Bill. They are:

- The nature of activities that are to be supported
- The burden of proof or evidence required to substantiate eligibility
- The compliance burden imposed on claimants who seek to benefit from the Bill's provisions.

Consequently, the threshold questions that remain are whether the positive changes in the Bill are sufficient to deal with the concerns that have been expressed by stakeholders in their submissions, and also presented to this Senate inquiry.

Does this Bill, when viewed as a package, reflect the policy objectives contained in *Powering Ideas* and implement the vision and strategic direction laid down by *venturousaustralia*? Does it provide greater administrative simplicity and transparency for claimants with improved support for commercially-oriented Australian R&D?

Our response to these questions is 'not yet'.

Compared with the existing R&D tax concession, the Bill will not deliver improved outcomes, administrative simplicity and transparency for many Australian corporates. In particular, all corporates with existing operations that undertake R&D as part of, or connected with, their production facilities will face a much higher threshold to include supporting R&D expenditures. This is the mainstay of business expenditure on R&D in Australia. The new feedstock provisions will mop up any residual benefit if the R&D happens to produce any marketable output.

The Bill has missed the mark is some important areas and we address these in some detail in this submission.

Summary recommendations

(a) The effective date should be deferred to years of income commencing on or after 1 July 2011. This deferral is required given the compressed nature of consultation with stakeholders after the release of the Bill on the 13 May 2010 and the need to address the concerns documented in this submission

(b) The definition of core R&D activities in paragraph 355-25(1)(b) should be amended to remove the word "about" so as to cover eligible R&D undertaken in the creation of new or improved materials, products, devices, processes or services explicitly

(c) The new definition of core R&D activities is more restrictive that the existing definition in section 73B of the *Income Tax Assessment Act 1936* (ITAA 1936). It will require claimants to effectively meet the requirement of 'both' innovation and high levels of technical risk in order to have an eligible core R&D activity. This restriction must be considered in combination to with the proposed restriction of eligible supporting activities

(d) Consideration must be given to removing the dominant purpose test in subsection 355-30(2). This test is inappropriately restrictive for the majority of Australia claimants that necessarily undertake R&D in a production or commercial environment

(e) We maintain that the term a "a purpose directly related to" with appropriate administrative guidance and robust administration is effective and appropriate to ensure only those supporting activities directly related to the core R&D are considered eligible

(f) In the alternative, we submit consideration should be given to the implications of adopting a substantial purpose test as a replacement for the dominant purpose test in subsection 355-30(2)
(g) Feedstock provisions in Subdivision 355-H need to be amended to ensure that the expenditure attributable to feedstock inputs in section 355-465 is not broader than the existing feedstock provisions in section 73B of the ITAA 1936
(h) The requirement for all claimants to document and attribute expenditure to core and supporting R&D activities as part of the registration process should be abandoned
(i) The meaning of aggregate turnover and connected entity must be amended in order to require control (more than 50%). The current 40% threshold is too low, and is inappropriate
(j) It should be made clear (at least in the Explanatory Memorandum) that the outright disposal of an asset developed as a result of R&D activities would generally fall within subparagraph 355-410(1)(b)(v) and *not* subparagraph 355-410(1)(b)(ii). To use intellectual property as an example, the granting of a licence to use the intellectual property would fall within subparagraph 355-410(1)(b)(ii), whereas an outright sale of intellectual property would fall within subparagraph 355-410(1)(b)(v)
(k) The *Income Tax (Transitional Provisions) Act 1997* (Transitional Provisions Act) should be amended to include a specific transitional provision in relation to section 355-410. That transitional provision should provide that section 355-410 applies to the disposal of R&D results occurring after commencement of the new legislation (presumably 1 July 2010), even though some or all of the relevant R&D claims were made under section 73B of the ITAA 1936
(l) There are numerous errors in the Explanatory Memorandum, which references out-of-date or incorrect subdivisions and sections in the Bill. We have included (as Appendix A) a table highlighting the paragraphs in the Explanatory Memorandum that contain these errors, together with suggested corrections.

Detailed submission

Nature of activities supported

(a) Core R&D activities

The definition of core R&D in section 355-25, although improved from the definition in the exposure drafts of 18 December 2010 and 31 March 2010, does not explicitly and sufficiently cover **application** R&D. This stems from the policy position that greater benefits flow to the broader community from generating knowledge rather than from the application of knowledge that is the product of the R&D. There has been no evidence presented during this policy debate that the public subsidy for new knowledge creation will yield a greater economic benefit than the subsidy of the application of that new knowledge to the creation of new products, processes, services, devices, etc. We believe that this premise is flawed, with significant public benefit and wealth creation occurring where the focus of R&D is its practical application. This is where the 'rubber hits the road', and tangible commercial outcomes are achieved, value and wealth created. It is also where corporates take on significant risks and technical failures are common.

The definition of 'core R&D activities' in section 355-25 has been amended to exclude the word 'knowledge' from paragraph 355-25(1)(b). The stated purpose of this amendment is to improve the application of this new definition to application R&D. We believe that this amendment does not go far enough to cover application R&D.

Paragraph 355-25(1)(b), as proposed in the second exposure draft, retained terminology used in the first exposure draft, i.e. "conducted for the purpose of generating new knowledge (including knowledge **about the creation** of..." [our emphasis]. The phrase "about the creation", when compared with the existing definition in subparagraph 73B(1)(a)(ii) of the ITAA 1936, which refers to "creating new or improved…", shifts the focus away from applied R&D, or 'development', towards 'research'.

It is clear that the focus of the new definition of core R&D is to provide incentive and support for activities undertaken for the purpose of acquiring new knowledge and information, where new knowledge is described in the Explanatory Memorandum as "knowledge not already available in the public arena at the time the activities are conducted, in the relevant technology, on a reasonably accessible world wide basis".

The proposed definition of 'core R&D activities' is experimental activities:

> *(a) whose outcome cannot be known or determined in advance on the basis of current knowledge, information or experience, but can only be determined by applying a systematic progression of work that:*
>
> > *(i) is based on principles of established science; and*
> >
> > *(ii) proceeds from hypothesis to experiment, observation and evaluation, and leads to logical conclusions; and*
>
> *(b) that are conducted for the purpose of generating new knowledge (including about the creation of new or improved materials, products, devices, processes or services).*

We recommend that paragraph 355-25(1)(b) be amended to omit the word 'about' to make it explicit that any eligible R&D undertaken for the purpose of 'creating' new or improved materials, products, devices, processes or services is eligible.

In addition, although the new definition omits the terms ‘considerable novelty’ and ‘high levels of technical risk’, it essentially retains the meaning behind those two terms and carries their meaning with the ’and’ test into the new R&D tax offset. Consequently this definition, although new in construction, does not in substance significantly differ from the definition proposed in the first exposure draft and second exposure draft. The concerns raised then remain relevant now. It is more restrictive that the existing definition of research and development activities contained in section 73B (1) of the ITAA 1936.

(b) Supporting activities

The Bill has continued the theme of restricting supporting activities, as foreshadowed by the second exposure draft legislation. Disappointingly, this restriction fails to recognise the necessary activities that are undertaken within a production environment while production activities continue to occur.

The current R&D tax concession program allows supporting activities that have a dual purpose, (i.e. where the activity is undertaken for R&D purposes as well as for production purposes), to be claimed. This sensibly acknowledges that commercial constraints mean production activities cannot come to a halt so that R&D activities can be undertaken. It also recognises that in order for research **and development** activities to take place, production facilities will necessarily be utilised, particularly where the R&D activities are aimed at developing new or improved processes.

The definition contained in the Bill significantly diverges from this for those activities that “produce goods or services”, or are “directly related to producing goods or services”. In these cases, the activities need to be undertaken with the “dominant purpose” of supporting core R&D activities. Dominant purpose is described in the Explanatory Memorandum as meaning the prevailing or most influential purpose.

The dominant purpose test also extends to those activities that are “excluded activities” (as defined by the Bill).

The breadth of the proposed definition is concerning. Our main concerns are:

- ***The phrases “produces goods or services” and “is directly related to producing goods or services” remain undefined.*** Notably, the Bill incorporates a change to the wording of this restriction. The second exposure draft referred to “…the ***production*** of goods or services” [our emphasis], rather than “*produces goods or services*” or “producing goods or services”. It is unclear whether this change has the purpose of widening this restriction further, as it is not explained in the Explanatory Memorandum.

  These words have a wide meaning. This will limit the application of the R&D tax offset to an incentive that is no longer industrially based, but is weighted towards scientific development. Arguably this will also affect Australia’s global competiveness, as to date the R&D tax concession program has been highly attractive because it recognises the need to undertake R&D within a commercial production environment.

  The inclusion of both goods **and** services also makes this an all-inclusive provision. There will be few industries that will not feel the impact of this restrictive provision

- ***The Bill does not reflect the manner in which R&D is undertaken with normal business operations.*** It may not make sound business sense for a company to cease its production activities, or dramatically change the course of its production activities (as suggested in the Explanatory Memorandum), so as to undertake an R&D trial that qualifies for the new R&D tax offset. To do so may be economically prohibitive, as organisations generally need to continue their commercial operations while they undertake R&D. The R&D activities need to be undertaken within the context of a business and not run in parallel with the operations of the business. The latter course will result in an organisation operating a business predominantly to undertake R&D. R&D is not the driver of most businesses but is generally a key component within them. The tax offset should be framed with this in mind.

This restrictive definition may significantly reduce the effectiveness of a Government support program in stimulating R&D within an industrial environment. The drafters of the Bill have failed to recognise the manner in which R&D is undertaken by industrial-based businesses within Australia

- ***The provision introduces a highly subjective component, which will necessarily increase compliance costs and cause confusion and inconsistency in its application.*** The Explanatory Memorandum notes that "factors such as the extent to which normal production practices are disrupted or the ***risk that production outcomes will be significantly compromised*** will be relevant in determining whether the experimental activities are taking advantage of an essentially normal production run, or whether the production run is being conducted for the dominant purpose of facilitating the experiment" [our emphasis].

  In assessing these factors, many subjective tests are likely to be applied, including how one determines the risk that production outcomes will be significantly compromised. Will it be sufficient to demonstrate that if the technical risks associated with the R&D are realised, there is *the risk that production outcomes will be significantly compromised*? What is the burden of proof required to substantiate this? No direction is provided about the level of documentation for compliance.

  For example, how would this result where a company undertakes R&D to develop a new vegetable-based food product? A significant risk that needs to be overcome will relate to the ability to develop the product formulation so that it can be manufactured within a particular production environment without introducing bacteria, contaminants and other product de-stabilisers into the process. The only manner in which this can be overcome is to run trials during the production phase so that the production parameters can be experimented with while the product is being processed on a full scale. Such operating conditions cannot be sufficiently tested within a laboratory. Would such risks be sufficient to demonstrate that there is a risk that production outcomes will be compromised? The examples provided in the Explanatory Memorandum are not definitive and leave many questions about eligibly of supporting activities open

- **The provision adds to the complexity of defining eligible R&D activities, which will burden claimants with increased compliance costs.** This Bill will not simplify the law. Instead, the introduction of these new definitions will present additional layers of compliance and cost for claimants. A claimant will need to consider:

  - Is the activity a core R&D activity?
  - If not, is it a supporting activity that is directly related to a core R&D activity?
  - Is it an excluded activity and if so, is it undertaken for the dominant purpose of supporting a core R&D activity?

- Is it an activity that produces a good or service?
- Is it an activity directly related to producing a good or service?
- Is it for the dominant purpose of supporting core R&D activities?

We consider that the term a “a purpose directly related to” with appropriate administrative guidance and robust administration is effective and appropriate to ensure only those supporting activities directly related to the core R&D are considered eligible

If the Government is firmly wedded to the policy of restricting the eligibility of supporting R&D activities and associated expenditures however, we recommend that consideration be given to amending the definition of supporting R&D activities in subsection 355-30(2) to replace the word “dominant” with the word ***“substantial”***.

A ‘substantial purpose’ test for supporting R&D activities in the circumstances defined in section 355-30 will still require a much higher eligibility threshold when compared with “directly related”, but will more appropriately reflect the practical and commercial reality that R&D undertaken in a production/commercial facility may well have more than one purpose and the R&D purpose may not be the dominant one. As long as the R&D purpose is substantial, it should be appropriate to allow the supporting activities to be eligible.

The ‘dominant purpose’ test is a well known one in the tax context. It features in the anti-avoidance provisions of Part IVA of the ITAA 1936 (and in the anti-avoidance provisions of the *GST Act 1999*). A critical feature of the dominant purpose test in the anti-avoidance context, however, and an important point of difference from the proposed test in the Bill, is the **objective** nature of the test.

As the High Court observed in Commissioner of Taxation v Hart [2004] HCA 26, “…*the inquiry required by Pt IVA is an objective, not subjective, inquiry. The objective nature of the inquiry required is evident from s 177D, which identifies the schemes to which Pt IVA applies*”. More particularly, “…*s 177D(b)… requires the drawing of a conclusion about purpose from the eight identified objective matters; it does not require, or even permit, any inquiry into the subjective motives of the relevant taxpayers or others who entered into or carried out the scheme or any part of it*”.

The dominant purpose test included in the Bill is a **subjective** test. Its application does not involve reference to any identified objective criteria. Its application will not be assisted by any familiarity among taxpayers and the Commissioner with the dominant purpose test in the anti-avoidance provisions.

In support of our alternate proposal that the test be amended to a ‘substantial purpose’ test, we note that the ITAA 1936 already includes a ‘substantial purpose’ test (section 6F) and many other instances of the adjectival use of the word ‘substantial’. The adverbial use of the word ‘substantially’ is also very common in the ITAA 1936. Our review of the tax case law does not reveal that the use of ‘substantial’ (or ‘substantially’) has presented difficulties for taxpayers or the Commissioner resulting in litigation. We regard this as a positive indication that the introduction of a subjective ‘substantial purpose’ test into the R&D provisions (to replace the subjective ‘dominant purpose’ test currently in the Bill) is unlikely to present difficulties for taxpayers or the Commissioner as the test for determining eligibility of supporting activities.

(c) Feedstock provisions

The Bill contains a new set of feedstock provisions in subdivision 355-H. The new feedstock provisions have a broader application than the existing provision in section 73B of the ITAA 1936. This has been achieved by expanding of the basket of expenditures included in the definition of feedstock input, broadening the concept of feedstock output (the marketable output) and giving the provision multiple year application.

The new provisions will effectively operate to clawback the incentive component of the R&D tax offset. This is achieved not by reducing the notional feedstock expenditure, as is the effect of the existing provisions, but by returning as assessable income an amount equal to one third of the lesser of feedstock expenditure and feedstock revenue. When this is multiplied by the corporate tax rate of 30% this will generate a negative tax benefit equal to 10% of the tax offset.

There is a range of interesting issues associated with this approach.

Firstly, for companies with group turnover below $20 million that can access the 45% tax offset, the 15% tax benefit will only ever be clawed back by a maximum of 10%. Consequently, these claimants will always enjoy a 5% tax offset that cannot be clawed back by the feedstock provisions. This is positive for SMEs.

For all claimants in a tax loss position, the impact of any feedstock adjustment is deferred where a refundable tax offset is received or where a claimant is still in a tax loss position. This is also positive, in that it defers the impact from a cash-flow perspective.

The new feedstock provisions can now apply across multiple years of income, unlike the existing provisions, as the adjustment mechanism is the return of assessable income and not the adjustment of feedstock expenditure. There is no requirement to adjust prior year claims. As an adjustment mechanism this is preferable to having to adjust feedstock expenditure incurred in prior years as it will reduce compliance costs and the need to amend lodged income tax returns.

The building blocks of the feedstock adjustment have also been modified, and the changes are important.

The feedstock adjustment continues to apply to goods or materials (feedstock inputs) that are transformed or processed during the course of R&D activities that produce one or more tangible products (feedstock outputs).

The basket of costs included in the calculation has been extended in paragraph 355-465(1)(b) to include:

(i) *…expenditure…*

(ii) *…energy input directly into the transformation or processing…*

(iii) *…decline in value of assets used in acquiring or producing the feedstock inputs...*

This is a clear extension of the costs to be swept up in this calculation and a departure from the existing practice as set out in the Commissioner of Taxation's fact sheet about the application of the current feedstock provisions. The use of the word 'expenditure' in subparagraph 355-465(1)(b)(i) will arguably now require the inclusion of labour, and direct and indirect costs associated with the creation of the feedstock output.

Feedstock output is defined as one or more tangible products that have come into being through a process or transformation through the process of R&D activities (marketable product). The key is that this feedstock output is supplied to another entity or it is applied to the entity's own use (other than for the purpose of it being further transformed or processed).

To determine if the feedstock adjustment exists, claimants will need to compare the feedstock revenue attributable to the feedstock output to the cost of the feedstock input. This process is not straight forward. The determination of feedstock revenue where the feedstock output is not sold requires a complex market-value calculation, which requires the calculation and attribution of the cost of producing the feedstock output relative to the cost of producing the marketable product to its market value.

This calculation will be required for each class of feedstock output. The way it operates effectively reduces the operation of the tax offset to a limited subsidy for failed R&D outcomes. When considered in light of the new restrictive definition of core R&D activities and the dominant purpose test for supporting R&D activities connected with the production of goods and services, this provision will render the final blow to any R&D undertaken in a commercial context that happens to be successful in the year the R&D is undertaken or in future years.

(d) Documenting core and supporting activities

Disappointingly, claimants will still be required to document and cost core and supporting R&D activities separately on registration of their activities. This will be a heavy burden on all claimants and in particular many of the SMEs that are the focus of this new Bill. We are not aware of any claimants that have project-costing methodologies that would identify and attribute expenditures based on the legislative definition of core R&D and supporting R&D activities.

The majority of claimants that use project accounting will do so on a project basis. The activities and expenditures captured in projects are made up of many activities; some will meet the definition of core R&D activities, some the requirements of supporting R&D activities, and many of which will be a blend of both. The requirement to identify, dissect and then attribute expenditures as proposed in the Bill will necessarily require significant additional compliance time and cost, as well as require a high degree of subjective judgement.

We recommend that this proposal be abandoned.

(e) Grouping

The grouping rules contained within the meaning of ‘aggregated turnover’ (section 328-115 of the *Income Tax Assessment Act 1997* [ITAA 1997]) and meaning of ‘connected with an entity’ (section 328-125 of the ITAA 1997) mean that companies (other than exempt entities) will be grouped when ownership is 40% or more, as opposed to the requirement under the current law of 50% or more.

This threshold is too low and we recommend that the threshold for grouping be returned to 50% as is the case with the current R&D tax concession.

This threshold is also lower than the threshold that the Bill imposes for exempt entities; they will be grouped when there is 50% or more ownership.

(f) Disposal of the results of R&D

The Bill contains some changes to the drafting of section 355-410 from the second exposure draft. Section 355-410 is an integrity measure under which proceeds from the disposal of the results of R&D activities are included in assessable income. The disposal of results of R&D activities includes, for example, the receipt of an amount from the granting of access to, or the right to use, any of the R&D results or an amount from disposing of a CGT asset (or from granting a right to occupy or use a CGT asset) where the disposal (or grant) resulted in another person acquiring a right to access or use any of those results.

In the second exposure draft, the amount included in assessable income for the disposal of any R&D results was, broadly, the amount received or receivable for that disposal unless there was a disposal (or the grant of a right to occupy or use) a CGT asset that was also a depreciating asset, in which case only the excess over the depreciating asset's cost was included in assessable income. The Government has accepted our recommendation to extend this treatment to all CGT assets, not just to depreciating assets. As such, where the results amount is derived from the disposal of a CGT asset, the assessable income can be limited to the amount received or receivable less the cost of the asset just before the disposal or grant.

Unfortunately, there is some doubt in the interpretation of section 355-410 as drafted in the Bill. The ability to offset the cost base of a CGT asset (as described above) is limited to situations where the results amount is derived ***only*** from the disposal of a CGT asset. In other words, if the results amount also falls within any of the other categories of 'results amounts', the cost base of the CGT asset cannot be used to reduce the results amount, (i.e. gross proceeds are assessable). Of particular concern is the interpretation of a results amount derived "from granting access to, or the right to use, any of [the R&D] results". These words appear in the current R&D legislation, and the 1990 Explanatory Memorandum to the current legislation indicates that these words should be interpreted to include the outright sale of rights. It is debateable whether this is the correct legal interpretation of these words. An alternative interpretation is that granting access to or the right to use an asset connotes providing something less than full ownership. If the ATO applies the same interpretation of this phrase in the context of section 355-410, the changes made in the Bill will be rendered meaningless in many situations.

For example, in the context of the sale of intellectual property rights developed as a result of R&D activities - if the proceeds from the sale of the entirety of the intellectual property rights are treated as an amount derived from the "granting of access to, or the right to use" the R&D results, the gross proceeds will be assessable under section 355-410. This is despite the intellectual property also being a CGT asset (and possibly also a depreciable asset) and even though the taxpayer may have cost base in that CGT asset.

It should be made clear (at least in the Explanatory Memorandum) that the outright disposal of an asset developed as a result of R&D activities would generally fall within subparagraph 355-410(1)(b)(v) and not subparagraph 355-410(1)(b)(ii). To use intellectual property as an example, the granting of a licence to use the intellectual property would fall within subparagraph 355-410(1)(b)(ii) whereas an outright sale of intellectual property would fall within subparagraph 355-410(1)(b)(v).

The Government has not accepted our recommendation about the application of section 355-410; to include a specific transitional provision to confirm that section 355-410 applies to all disposals of the results of R&D activities occurring after the commencement of the new legislation, (i.e. even where the R&D claims were made under section 73B of the existing legislation). Instead, some additional wording has been added to the Explanatory Memorandum indicating that the existing law (subsection 73B (27A) of the ITAA 1936) continues to apply to the extent that R&D claims were made under section 73B of the existing legislation.

For the purposes of section 355-410, the disposal of the R&D results is the relevant event to which the R&D rules should be applied; it is largely irrelevant whether the actual R&D claim was made under the existing law (subsection 73B(27A)) or under the new law. As such, if the disposal occurs after the new law is in place, it is our view that the new law should apply.

If the current position set out in the Bill is maintained, this will require taxpayers to apportion the amount received for the disposal of the R&D results between that which relates to R&D claims made under the existing law and R&D claims made under the new law, and then to do separate calculations under subsection 73B(27A) and section 355-410 based on the amounts allocated. There is no method provided in the Bill for allocating the amount received between R&D claims made under the existing and new law. Furthermore, given that R&D claims are generally made for a number of years before a particular asset is developed (and it could be even longer before that asset is sold), subsection 73B(27A) is likely to remain *operative* for many years in the future. It should be noted that this is not a simply a case of having regard to R&D claims made under existing law; the calculation of a taxable amount will actually need to be undertaken under a section that has been repealed, possibly, many years earlier.

The Transitional Provisions Act should be amended to include a specific transitional provision in relation to section 355-410. That transitional provision should provide that section 355-410 applies to the disposal of R&D results occurring after commencement of the new legislation (presumably 1 July 2010), even though that some or all of the relevant R&D claims were made under section 73B of the ITAA 1936.

Deloitte.

Appendix A

Incorrect Bill references in the Explanatory Memorandum

EM paragraph	Incorrect reference	Correct reference
2.12	Schedule 1, item 1, paragraph 355-25(a)	Schedule 1, item 1,paragraph 355-25(1)(a)
2.16	Schedule 1, item 1, paragraph 355-25(b)	Schedule 1, item 1, paragraph 355-25(1)(b)
2.23	Schedule 1, item 1, paragraph 355-35(2)(a)	Schedule 1, Item 1, subsection 355-25(2); paragraph 355-30(2)(a)
2.32	Schedule 1, item 1, paragraph 355 35(2)(a)	Schedule 1, item1, subsection 355-25(2); paragraph 355-30(2)(a)
3.3	Second reference to Part 3 of Schedule 3	Parts 2 to 6 of Schedule 3
3.18, 3.19, 3.24	Schedule 1, item 1, section 355 – 40 (This is only in the ED v2)	Schedule 1, item 1, section 355 – 35
3.46	Schedule 1, item 1, section 355 – 115	Schedule 1, item 1, section 355 – 110
3.61	Schedule 1, item 1, subsection 355 – 20(2)	Schedule 1, item 1, subsection 355 – 220(2)
3.131	Schedule 1, item 54, section 4-25	Schedule 3, item 54, section 4-25
3.157	Schedule 3, item 44, subsection 136AB(2)	Schedule 3, item 47, subsection 136AB(2)
3.205	Schedule 1, item 1, section 355-699	Schedule 1, item 1, section 355-700
5.111	Schedule 2, item 1, ss27A(2)	Schedule 1, item 1, subsection 355-705(2)
5.151	Schedule 2, item 1 ss 30C(3)	Schedule 2, Item 1, subsection 30C(2); section 32