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Our ref Tax Laws Amendment (2007 Measures
No2)Submission-Final-MM
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**Tax Laws Amendment (2007 Measures No2) Bill 2007
Schedule 3 - Research and development, Item 19
Distribution of the Premium Incremental Concession**

Introduction

On 29 March 2007, the Senate referred the provisions of the Tax Laws Amendment (2007 Measures No 2) Bill 2007 to the Senate Economics Committee (SEC) for reporting by 30 April 2007. The SEC has invited written submissions on the Bill. This submission is in respect of certain aspects of the amendments in connection with research and development (R&D) activities.

Schedule 3 of this Bill amends the provisions of the Income Tax Assessment Act 1936 (ITAA) relating to expenditure on R&D. These technical amendments introduce provisions impacting upon the premium R&D tax concession.

KPMG welcomes correcting a situation whereby allocating the premium between the current (Y0) and prior year (Y-1) R&D claims of companies in a group, an unintended consequence was to deprive corporate groups of the premium concessional amount. The Bill's wording resolves the anomaly [Schedule 3, item 19] by amending section 73X(1) to allocate the premium based on the three year history.

However, in our view, the deferral of the date of application of the intended amendment until the year of income following the year of income in which this amendment receives Royal Assent defeats the spirit of the policy objective of rectifying this legislative anomaly. (Please refer to Appendix A for example.) As these measures are a concession, they should be retrospective to 1 July 2001 to reflect the policy intent outlined in the Backing Australia's Ability innovation measures.

Background

The incremental tax concession program was introduced in 2001 with the objective of encouraging additional business investment by companies in R&D over and above their prior levels of spending on R&D.

However, it should be noted that the premium incremental concession has not been accessible by some taxpayers since its introduction, due to the method of apportionment of the premium amount between group members. The proposed changes to the apportionment method attempt to resolve the unintended consequences imposed by the current legislation.

By way of background, the current legislation allows a single company that had increased its R&D expenditure above its three year rolling average to access the premium incremental concession [sections 73P to 73Z of the ITAA].

However, if that company is part of an R&D group, it is required to satisfy an additional criterion: at least one member of the R&D group must have expenditure in the current year of income which is greater than its R&D expenditure in the prior year (section 73X).

The amendments proposed in the Bill will eliminate this additional criterion and rectify an anomaly between a standalone company and a member of an R&D group. As this inconsistency was an unintended consequence, we welcome the proposal to remedy the situation.

Application Date

It is proposed that this remedy apply with effect from the year of income following the year of income in which the Act receives Royal Assent.

This application date means that many companies remain adversely affected despite achieving the Government's stated objective of increasing their investment in R&D over prior years.

These companies have been unfairly penalised by foregoing significant incremental tax concession benefits. In addition, future years' access to the premium incremental concession is more difficult as the expenditure remains in the companies' prior year history. That is, companies which are adversely impacted by the unintended consequences of the current legislation will, in effect, be further penalised in current and future, unless the application date is made retrospective.

The Government recognised that this was an unintended consequence in its May 2006 Federal Budget. However, the current proposed amendments are not likely to come into effect until, at the earliest, the 2007 – 08 income year.

While we very much support the proposed amendment to the premium distribution rules attempting to restore the original policy intent, we believe that these measures should compensate companies detrimentally affected by the current legislation. This can be achieved by allowing these companies to retrospectively access the incremental concession benefits otherwise lost due to the shortcomings of the present legislation. Such a result would be a fair and equitable outcome for those companies who have missed out on R&D benefits.

Therefore, we recommend that the amendment relating to the distribution of the incremental amount apply to years of income commencing on or after 1 July 2001, which is the date of commencement of the premium incremental concession. If this recommendation is not accepted, then we would submit that, at a minimum, the amendment should apply to years of income ending on or after 9 May 2006, i.e. the date of the announcement of this amendment.

Summary

Many companies have relied on the R&D tax concession and its incremental component, to embark on innovative and highly technically challenging projects, in accordance with the legislative intent of the R&D Tax Concession. These companies have been unjustly penalised by forgoing claiming under the premium incremental concession.

We strongly recommend a retrospective application of the new premium distribution rules.

If adopted, this measure would reverse the inherent, albeit unintended consequences imposed by the current legislation by way of denying access to the premium deduction to, otherwise, eligible companies. We consider that it would also provide these companies with an additional incentive to continue investing in R&D in the future.

We will welcome the opportunity to provide further information as necessary.

Should you have any queries, please do not hesitate to contact me.

Yours sincerely



David Gelb
R&D Partner

Enclosures:
Appendix A - Example



Appendix 1
Premium Tax Concession
Allocation of Increment anomalies

Example 1

Section 73X

reference	Y0	Y-1	Y-2	Y-3	Average	Increment	Deduction (Bill No 2)	Deduction (old law)
Year of income	2006	2005	2004	2003				
Company A	3,500,000	3,600,000	120,000	900,000	1,540,000	1,960,000	980,000	-
Company B	700,000	750,000	750,000	500,000	666,667	33,333	16,667	-
Group R&D	4,200,000	4,350,000	870,000	1,400,000	2,206,667	1,993,333	996,667	Nil

Had it been a stand alone company (or consolidated tax group)
it would have been entitled to an incremental tax deduction of: \$ 996,667

By delaying change until Royal Assent, in future years, Company A remains doubly penalised because the large claim in 2006 is included in its history, even though it did not benefit from the premium concession in 2006. That is:

Section 73X

reference	Y0	Y-1	Y-2	Y-3	Average
Year of income	2007	2006	2005	2004	
Company A	?	3,500,000	3,600,000	120,000	2,406,667
Company B	?	700,000	750,000	750,000	733,333
Group R&D	?	4,200,000	4,350,000	870,000	3,140,000

The R&D group's average has increased by \$933333 and the companies must now raise the bar even higher in 2007 to access the premium. However as the premium concession was not available in 2006, the incentive to increase R&D activity is lost.