



24 February 2010

Mr Kris Gale  
Managing Director  
Michael Johnson Associates  
PO Box 542  
BALMAIN NSW 2041

By email

Dear Mr Gale

#### PROGRESSING THE NEW R&D TAX INCENTIVE

Thank you for your submission on the exposure draft legislation for the research and development (R&D) tax incentive. I am writing to let you know how Treasury (with the Department of Innovation, Industry, Science and Research), on behalf of the Government, plans to progress implementation of the new scheme.

Based on the submissions received, we understand that stakeholders have five main areas of concern (the table attached provides a summary). With the benefit of this feedback, we understand that in some areas the proposed rules could have unintended consequences while in others the draft legislation needs to be made clearer and less complex. We are currently examining ways to address these areas along with some issues of a more technical nature that stakeholders have brought to our attention. The results of this work will see some changes to the draft legislation and further clarification in the associated explanatory materials.

During recent dialogue, some stakeholders have undertaken to provide us with examples of genuine R&D that they believe would not receive support under the new tax incentive as currently drafted. Such information will be a vital input to the next phase of the process. Therefore, we encourage you to provide any examples or suggestions that have occurred to you since making your recent submission. You can send these by email ([rdtaxcredit@treasury.gov.au](mailto:rdtaxcredit@treasury.gov.au)) or by post to the address below. We will deal with information on a confidential basis, if you wish.

We intend to make a new version of the draft legislation available for your further comment as soon as possible. The revised draft legislation will be published on the Treasury website and we will send you a link to the revised draft legislation when it becomes available. Notwithstanding this further consultation, we continue to expect that the new R&D tax incentive will be available for income years starting on or after 1 July 2010.

Yours sincerely

Paul McCullough  
General Manager  
Business Tax Division

<p>Stakeholder concerns</p>
<p>Core R&amp;D activities</p> <p>The current law defines ‘innovation’ as involving an ‘appreciable element of novelty’. The exposure draft substituted ‘considerable’ for ‘appreciable’.</p> <p>The current law requires that core R&amp;D activities involve innovation or high levels of technical risk, whereas the exposure draft seems to require both elements.</p> <p>Stakeholders have interpreted these changes as imposing a more demanding test.</p>
<p>Supporting R&amp;D activities</p> <p>The current law requires supporting R&amp;D activities be undertaken for a purpose directly related to carrying on core R&amp;D. The exposure draft requires supporting R&amp;D activities be undertaken for the dominant purpose of supporting core R&amp;D.</p> <p>The exclusions list in the current law only applies to core R&amp;D. The exposure draft extends those exclusions to supporting R&amp;D as well.</p> <p>Stakeholders are concerned about the scope of the activities excluded from the scheme because of these changes.</p>
<p>R&amp;D activities involving software</p> <p>The current law excludes ‘in-house’ software, by requiring eligible software R&amp;D activities to result in a supply to at least two customers. The exposure draft requires the supply (to at least two customers) to be on a commercial basis and excludes computer software services and the integration of off-the-shelf commercial or open source software.</p> <p>Stakeholders are concerned that the proposed rules will eliminate much of the R&amp;D they are claiming under the current scheme.</p>
<p>Registration of core and supporting R&amp;D activities</p> <p>The current law differentiates between core and supporting R&amp;D, but does not require taxpayers to register their core and supporting R&amp;D activities separately. The exposure draft requires taxpayers to register their core and supporting R&amp;D activities separately.</p> <p>Stakeholders have expressed concerns about the associated compliance costs.</p>
<p>Augmented feedstock rules</p> <p>The current law can reduce the amount claimable for the cost of goods and materials that are processed or transformed in R&amp;D activities, and for the related energy inputs. Such costs are only eligible to the extent that they are less than the value of the resulting output.</p> <p>The exposure draft extends this approach to the ‘production costs’ of all direct outputs of R&amp;D activities, while continuing to allow an appropriate claim for the costs of non-production R&amp;D activities.</p> <p>Stakeholder concerns revolve around the potential scope and application of the proposed changes. A common perception is that the new rules would operate to penalise ‘successful’ R&amp;D.</p>