Private & Confidential

The Treasury
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22 April 2016

Dear Sir or Madam

Exposure Draft Law - National Innovation and Science Agenda

PwC welcomes the opportunity to comment on the latest raft of exposure draft law - *Tax and Superannuation Laws Amendment (2016 National Innovation and Science Agenda) Bill 2016* - to support the initiatives released in the Australian Government's National Innovation and Science Agenda (NISA) that relate to access to losses and intangible asset depreciation.

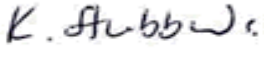
PwC is one of Australia's leading professional services firms and our mix of clients is diverse and reflects Australia's broad and varied capital market. We serve entities of all forms and sizes, both public and private, which range from new entrants to established entities.

PwC strongly supports changes to the income taxation system that can remove barriers to innovation and we would recommend that these measures be implemented as soon as practical. We have commented on each of the legislative proposals in the attached Appendices.

PwC is committed to positively contributing to the Australian community and supporting and enabling the initiatives contained in the Government's NISA. As a firm we are a strong advocate for the need to build an innovative Australia and believe that our national success in doing so will have a direct impact on our country's future prosperity.

We would welcome the opportunity to discuss our views further. Should you wish to do so, please contact Anthony Klein on (03) 8603 6829 (or anthony.klein@au.pwc.com) or Kristin Stubbins on (02) 8266 2208 (or kristin.stubbins@pwc.com).

Kind regards,



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Appendix A - Access to Losses

PwC has long been advocating for reforms[1] to simplify the current "same business test" (SBT), which applies to companies and listed widely held trusts seeking to deduct losses following a failure in continuity of ownership.

It has been our experience that the SBT is of great concern for loss companies that seek to diversify into more profitable activities, adapt to changing markets and/or adopt innovative business practices.

We welcome the fact that the exposure draft goes some way to reform the current SBT by replacing it with the "business continuity test". However, in our view, more could be done, if not as part of the Government's NISA agenda, but as part of broader structural tax reform to rewrite the SBT so that it is simpler, more efficient for companies to apply following a change in ownership and more aligned to an era where disruptive business practices should be encouraged as a catalyst for innovation and growth, not discouraged by out-of-date tax policy.

We encourage the Government to extend its proposal to ensure the practical benefits of the change have a more substantial impact in practice to reduce the uncertainty for certain businesses (particularly small and medium sized enterprises) accessing past tax losses.

In the context of the current exposure draft our key comments below relate to the start date of the proposal and the practical application of the 'similar business test'.

Start date

Based on the proposals, the exposure draft law would apply to losses incurred in income years starting on or after 1 July 2015. We strongly encourage the Government to consider allowing it to apply to losses that are sought to be deducted or applied in income years commencing on or after 1 July 2015, regardless of the year in which the loss was incurred.

In our experience, there are companies that have already incurred losses in years prior to the current year that would seek out and adopt new business opportunities and activities if they had access to new capital and/or investors. These companies are limited by the extent to which they can access new capital investors to assist them to modify and innovate their existing business without suffering the additional cost of forgoing un-deducted prior year losses. If the exposure draft law is enacted in its current form, a company in such a situation is put at a disadvantage when seeking new investors as compared to one that has only suffered losses since 1 July 2015.

To ensure that the proposal remains appropriately targeted and without introducing retrospective application, it could, for example, apply to losses sought to be deducted or applied where there has been a change in continuity of ownership at any time in income years commencing on or after 1 July 2015. This would remove the barrier for existing loss-making companies to seek out new equity investors to support their potential to return to profitability by innovating or growing their existing business.

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[1] As recently expressed at 3.4.2 of PwC's submission to *Re:Think Tax Discussion Paper* , 1 June 2015

Practical application of the similar business test

Although we acknowledge that the concept of "similar business" is a question of fact and degree, we consider that many taxpayers will face uncertainty in ascertaining whether or not a company's current business is similar to its former business.

At the outset, it is our view that it should be easier for a company to satisfy the similar business test as compared to the same business test. However, that is not readily apparent from proposed section 165-211 as drafted.

In the absence of clear guidance or a clear statement of intent in the law, many taxpayers who require increased certainty will be faced with the additional compliance cost of seeking a ruling from the Australian Taxation Office (ATO). New investors in a loss company will want to understand whether any proposed change in business activity following their investment will or will not jeopardise the company's ability to utilise existing carry forward losses.

While the examples in the explanatory material are intended to help taxpayers understand the degree to which changes in a business' operations and activities might be considered to amount to the carrying on of a similar business, we find the examples confusing and the conclusions not always as expected[2]. There is a strong emphasis in the examples on the retention of a business brand name, regardless of any actual distinct change in the identity of the business[3], and it is unclear whether that is ultimately a key deciding factor.

An example in the explanatory material that covered the simple case of a retail business evolving from having one or more physical shop-fronts to an online presence would be useful. In our experience, this is a practical issue affecting a number of Australian corporate taxpayers.

We recommend that the ATO prepare (with suitable consultation) a binding Public Ruling or Law Companion Guideline (and/or a Practical Companion Guideline setting out an administrative "safe harbour" on the degree to which business changes may be acceptable) on the application of the business continuity test as soon as possible. This would assist affected taxpayers understand the extent to which the ATO will administer and apply the law.

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[2] In particular, Example 1.2 where it is concluded that the company would satisfy the similar business test after it commences to develop and sell teeth-whitening products.

[3] Example 1.2 where there is a change from retailing to retailing and manufacturing where the similar business test is satisfied, as compared to Example 1.3 where there is change from manufacturing and retailing to retailing where the similar business test is failed.

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Appendix B - Intangible asset depreciation

The Government's proposed changes recognise that intangible assets add 'real value' to more and more businesses in today's environment. This has also been recognised by other countries, such as in the UK and US, although the intangible asset depreciation rules in these jurisdictions are more extensive. We encourage the Australian Government to consider the merits of taking the proposed changes further so as to provide Australian businesses with an "innovation advantage" when it comes to the depreciation of intangible assets. This should provide companies with a fiscal incentive to hold intangible assets in Australia, which is consistent with the Government's NISA policy.

In respect of the exposure draft law, we welcome and support the proposed change to provide a mechanism for taxpayers to self-assess the effective life of intangible depreciating assets[4]. Not only does it provide a similar basis for claiming depreciation on intangibles as is applicable to tangible depreciating assets, but it also affords taxpayers the opportunity to better align the tax treatment of intangible assets with the actual period of time that the assets provide economic benefits.

Importantly, the current proposal to change the tax treatment in Australia has the potential to encourage taxpayers to acquire existing intellectual property that is subject to tax depreciation from other taxpayers and potentially recoup the purchase price over a shorter period of time than would otherwise have been allowed.

We acknowledge and support the manner in which the policy objective is achieved by having the same legislative rules that currently apply to tangible assets also apply to intangible assets. While it is likely that there is no practical ability for an intangible asset to suffer "wear and tear" or that it "be maintained in reasonably good order and condition", the existing provision[5] caters for these factors to be taken into account only "if relevant for the asset".

In some cases, the self-assessed effective life for certain intangible assets (based on the legislative assumption that the asset can be used by any entity) will be the same as the statutory effective life, or it may be difficult to self-assess at the time the asset is first held. Having said that, we welcome the fact that the proposed new law allows a taxpayer the ability to recalculate effective life in a later year, as it is conceivable that circumstances change so that a new effective life would need to be calculated given the nature of some intangible assets (e.g. a change in technology).

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[4] In our submission to the *Re:Think Tax Discussion Paper*, 1 June 2015, we challenged the basis upon which a fixed period for write-off of intangible assets had been set into our current tax law.
[5] Section 40-105 *Income Tax Assessment Act 1997*