

26 October 2009

General Manager
Business Tax Division
The Treasury
Langton Crescent
PARKES ACT 2600

Dear Sir/Madam

RE: R&D Tax Credit Consultation Paper

NOAH Consulting welcomes this opportunity to provide feedback on the R&D Tax Credit Consultation Paper.

About NOAH

NOAH Consulting specializes in assisting companies seeking to access Federal Government support for innovation, with a primary focus on the R&D Tax Concession. NOAH's directors have in excess of 25 years experience in this area. Our client base ranges from small "start-up" businesses, to large global conglomerates, operating across a wide variety of industries, including software, construction, tooling, mining and resources, manufacturing, medical and health care.

We believe we are well placed to provide feedback regarding the proposed changes to the eligibility criteria governing research and development activities, and the likely impact these changes will have on claimants within the aforementioned industries.

Policy Intent and Fundamental Principles

NOAH supports the over-arching policy intent to simplify the program and provide proportionally higher benefits to small businesses.

We agree with the fundamental principle that the program should encourage and promote additional R&D activity. In our opinion, this objective is likely to be realized solely in the less than \$20M business segment, as a value proposition pitched at 10 cents in the dollar for businesses turning over greater than \$20M will not be sufficient to influence company behaviour in the context of other commercial drivers.

NOAH's experience in liaising with its client base over many years suggests that the additionality rationale would only be sustainable if the program offered at least twice the proposed level of support for companies with revenues exceeding \$20M, with the benefit being paid in advance of the project commencing.

Nevertheless, a strong case remains for supporting larger corporate innovation endeavours through a program that reduces the after tax cost of research and development. Importantly, many of these large organizations are responsible for generating a significant proportion of Australia's GDP and creating a high number of local jobs.

Specific Features and Questions

IP Ownership

NOAH welcomes the proposed withdrawal of the requirement for IP to be held by the claimant company. Such a change is commercially realistic and in keeping with the increasing trend towards globalization. Furthermore, this demonstrates the Government's understanding that the most important factor is the location of the R&D activity, with work conducted in Australia providing the desired employment opportunities and spill over benefits the program seeks to achieve.

Core R&D

Altering the existing definition of R&D to require "innovation" and "technical risk" will reduce the scope of activities currently eligible under the program.

In principle, NOAH supports this change. However, the interpretation of this amended definition by the program's administrators will have a significant impact on the willingness of companies to undertake and claim activities as eligible R&D. We would encourage the adoption of the legislatively accepted meaning of "innovation" and "technical risk" that would allow the continuation of support for incremental improvements to existing technologies and concepts.

There should be scope for companies to claim innovation in respect of the development of "me-too" products and processes that enhance competitiveness, where the know-how is not available on normal commercial terms. Such an interpretation is also consistent with the fact that the R&D Tax Credit is intended to be an incentive designed to promote and encourage a certain class of activity.

Supporting R&D

NOAH strongly supports the principle that supporting activities should continue to be recognized as eligible R&D activities. The retention of this concept is critical in achieving the program's intended objectives, and providing a meaningful benefit to companies, whilst recognizing commercial issues and challenges.

The majority of R&D projects undertaken globally are not viewed as being successful until the results of that project are successfully commercialized. As such, it is imperative that the program recognizes the significant investment companies undertake in all activities leading up to the commercialization of the results of an R&D project, which may include limited production trials conducted to evaluate the viability of commercializing the R&D results.

NOAH does not support a change to the definition of supporting activities that would effectively exclude production or dual-purpose activities. However, we recognize that the Government does not wish to support open-ended, production centred supporting activities. In recognition of this issue, we suggest that claims on these supporting and directly related activities could be contained by the introduction of an expenditure cap. The cap should reflect the reality that development activity in a production environment will cost companies more than conceptual activities. As such, we propose a "1:3 ratio" in terms of the breakdown between core and supporting activity expenditure on a project.

Further minimization of the cost to revenue associated with large claims for supporting activities could be effected by expanding the list of excluded activities to explicitly state that production trial activities cannot be claimed as systematic, investigative and experimental activities. This will prevent manipulation of project characterization with the intention of circumventing the ratio cap suggested above.

Software

NOAH supports the review of restrictions currently governing the eligibility of software projects. As stated in the Discussion Paper, the current "multiple-sale" test is outdated and no longer relevant in the current business environment.

NOAH does not support the institution of the UK-based criteria. We believe that software should not be treated any differently to any other R&D activity that satisfies all other eligibility criteria. Software applications and technologies play an important role in businesses across all industries, and will increase in importance in future years. The Government's investment and support of the National Broadband Network is clear evidence of this fact.

Restricting or excluding software developments as eligible R&D would have a profound negative impact on the Government's desire to establish Australia as a technology leader in the Asia-Pacific region.

Conclusion

The introduction of the *R&D Tax Credit* is the most significant change to the landscape in Federal Government Industry Support in decades. It is therefore imperative that the policy settings, and their potential impact on all industries and companies, be carefully considered and designed to be in tune with commercial issues and challenges.

The new program should also build on the strengths of the previous product offering in this area by preserving the broad based nature of the R&D Tax Concession by supporting, not just fundamental research, but also the development activities undertaken in real, live commercial settings whether they are undertaken on the factory floor, mine site or manufacturing line.

NOAH is a strong supporter of changes aimed at improving Australia's standing within the world's R&D community by encouraging local R&D activities. The implementation of the R&D Tax Credit has the potential to significantly boost local R&D, however we are acutely aware that the details governing eligibility of R&D activities will be the most influential factor in achieving the program's objectives. As such, we strongly urge the Government to carefully consider the impact of any proposed changes on both current and future claimants.

NOAH Consulting