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Manager, Small Business Entities & Industries Concession Unit
The Treasury
Langton Cresc
PARKES ACT 2600
rnamendments@treasury.gov.au

Dear Sir

Thank you for information regarding the draft Explanatory Memorandum and Explanatory Draft of Treasury Laws Amendment (Research & Development Incentive) Bill 2108. Also, your consultation on the Draft Treasury Laws Amendment and the questions which you posed.

Before touching on those questions, I would first comment in broad terms on the changes and the increasing complexity of this Act. That complexity is to such a degree that it would seem it has become an incentive for accountants and lawyers rather than an incentive for R&D and for those carrying out that R&D. Thus, there is a critical need to try to simplify the Act. I fear that the current proposals will rather do the opposite.

We note in the draft Explanatory Memorandum, in 1.2 that “the incentive is intended to support additionality in R&D activities and spill over benefits to the broader economy”.

We therefore wonder why there is such concern that the level of support has increased over 5 or 6 years. Is that not the aim of the Incentive? Also, why is there reference only to the costs within the Explanatory Memorandum rather than investment in intellectual property and the benefits which such investment brings and has brought to the economy? There seems to be significant inconsistency in these positions.

Equally, the desire to increase spill-over effects where much of this comes from large companies which seems to be negated by the constraints put on support for such large companies, firstly through including a cap of \$150million and secondly in the proposed calculations of intensity which will limit any support to many large companies to 4%. This low level of support is hardly likely to influence their decision to do any R&D in Australia, rather than overseas. There is also concern that companies with turnover of \$20million or more are treated as large companies with regard to support through the intensity calculations. A \$20million turnover would not normally be associated with the word “large”.

In regard to the calculation of R&D intensity, the numerator is restricted to the R&D expenses which exclude a number of items from a company’s total expenses including interest, legal, marketing expenses and other. Surely, the denominator should also have such expenses removed to provide consistency between numerator and denominator.

In regard to the Explanatory Memorandum, in Chapter 2 “Enhancing the Integrity of the Research & Development Tax Incentive”, we are concerned with the examples given which seem to confuse the feedstock revenue with the market value of the marketable product. The Exposure draft of The Act in 355-445 (4) sets out a theoretical concept for calculation of feedstock revenue as:

$$\text{Market value of the marketable product} \quad \times \quad \frac{\text{cost of producing the feedstock output}}{\text{cost of producing the marketable product.}}$$

Thus the feedstock revenue is only a part of the market value of the marketable product. This is not clear in the examples given in Chapter 2 including example 2.2. It is very important that clarity is achieved within the Explanatory Memorandum.

Within Chapter 3, we can see little benefit to the country in publishing such information. It is unclear why 3.11 says “as soon as practical after the end of the income year” when such calculations are often not yet complete and where Registration can be undertaken up to 10 months after the end of the financial year. We suggest a more practical approach would be to publish the information at the order of 12 months after the end of the financial year.

With regard to the questions you pose and the consultation on the draft Treasury Laws Amendment, we make the following comments:

- Re R&D intensity – we totally agree with you, this is potentially far too complex and creates much greater uncertainty for users who, for example, will not know what level of support they may get from this Incentive when embarking on an R&D project since they will not know the R&D intensity until the end of the financial year.
- This complexity inevitably leads to potential integrity issues and thus simplifications and abandonment of the concept of intensity would go well to improve integrity.
- In regard to question 3, could expenditure be aggregated across a broader economic group? This would vary according to individual circumstances and we suggest you let users select which approach they think to be most appropriate. We anticipate a large number of companies will simply wish to take the R&D intensity of the individual company or, if they have one, through a consolidated group for tax purposes.
- With regard to clinical trials – we have no comment.
- With regard to the question on draft feedstock and claw back provisions – we suggest you improve the clarity of feedstock revenue first of all before seeking answers to this question. We have noted details in the early part of this letter.

Yours sincerely,

Geoff Stearn
Managing Director
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