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**Thursday 4th February 2010**

To Whom It May Concern

On behalf of **Australian Interactive Media Industry Association (AIMIA)** - Innovation Research & Development Committee, I welcome this opportunity to provide feedback on the exposure draft of the Tax Laws Amendment (Research and Development) Bill 2010 released 18 December 2009 ("the exposure draft").

AIMIA is an industry body that represents 600+ companies in the ICT industry. A significant proportion of our members are in the business of developing innovative software for the global market. I myself am an entrepreneur with a number of successful companies and 7 years of experience in R&D. I also hold numerous positions with industry bodies and am an advocate of companies exporting their technology to Asia from an Australian base.

AIMIA commends the Government's stated intent in delivering a "more generous, more predictable, and less complex tax incentive", however we do not believe the legislation achieves this intent in its present form.

We believe a significant proportion of businesses undertaking R&D will be affected with the resulting effect likely to be:

1. wind up operations before the new legislation comes into effect;
2. offshore R&D into countries with more clearly defined and rewarding taxation structures such as Singapore;
3. plan commercialisation strategies in favourable regional hubs like Bangkok and Singapore with Australia as a last market approach; and
4. not begin innovative businesses in Australia as the start-up costs will be too high without R&D incentives.

The proposed legislation in its current form will:

1. unfairly restrict Research and Development in emerging markets like digital media and mobile telecommunications applications where innovation is occurring in software systems that are novel online services with core R&D innovation and patentable IP. The proposed legislation would appear to deny R&D benefits to these parts of the ICT industry on the basis that they are services rather than product developers. This area requires nurturing not a broad brush stroke that potentially wipes out any R&D claims; and
2. over burden SME's who may not have the funds or knowledge to seek advice.

This is a double whammy for businesses who already find it difficult attracting equity investment from overseas venture capital funds which are wary of the possible taxation impact of equity investment in Australian companies. The proposed "augmented feedstock" legislation may severely impact a start-up company at a critical point in its lifecycle in those circumstances where such a company commercialises its R&D effort. The success of the company may trigger the feedstock rules, creating the need for the company to repay the government the R&D benefits the company enjoyed during the development of the new service offering. Why would someone invest in an Australian company with an un-quantifiable financial position due to legislation that is not clearly defined?

So what are our members saying about the changes? Well, one of the more vocal comments was "The death of Innovation in Australia". Is this the death of innovation in Australia? It looks like it from an industry perspective, even if it is not at the least it will trigger a significant collapse of Australian R&D investment with resultant job losses in the local economy.

At a time when Australia is being recognised as a solid financial performer, government should be providing clarity not changes that create ambiguity and multiple hits to companies providing innovation.

Another choice comment from an ex investment banker now involved in commercialisation was "why would I invest in Australian R&D when there is less chance of securing capital investment and even if I can achieve that investment and we make a profit it will be clawed back?".

Whilst we understand the Government's intention to tighten eligibility in order to focus incentives on worthy activities which will provide spillover benefits to the broader Australian economy, we believe the combination of *the high number* of tightening measures contained in the exposure draft serves to drastically reduce the generosity, accessibility and attractiveness of the R&D Tax Incentive program.

Is the government's goal of fostering Australian innovation and industry growth being achieved by the introduction of the new legislation? We think not. We believe the new legislation will foster companies to windup prior to profitability or sell valuable IP assets to offshore countries that favour continued R&D. What it will do is decrease Australian ICT investment, create job losses and begin the migration of Australian professionals to smarter countries.

We have included specific examples related to our major concerns below.

### **Major concerns**

Within the exposure draft, there are now five key ways in which eligibility has been significantly tightened and claims will be curtailed, making the system *less generous, more complex and less predictable* to Australian businesses.

1. The requirement for 'considerable novelty' in place of 'innovation' – this both raises the bar for eligibility of potential claimants, while increasing uncertainty by replacing a well understood and defined term. Innovation is a well understood term, and the relationship between innovation, productivity and growth is similarly well understood, across OECD countries and in a local context. The shift in term seems to favour the "blue sky" R&D common in academic settings over business innovation – the incremental improvements which are vital to business competitiveness;
2. The introduction of the "and" test for the eligibility test of considerable novelty and high levels of technical risk. We believe that this change to the definition will lead to the exclusion of many genuine

