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Dear Sir/Madam

Submission: R&D Tax Incentive — Quarterly Credits

Please find below, our submission in relation to the Treasury consultation paper R&D Tax Incentive: Quarterly Credits.

About Swanson Reed

Swanson Reed is a leading specialist R&D tax provider that services a wide spectrum of clients across all locations in Australia.

In addition to Swanson Reed's group of chartered accountants, our team includes technical personnel with backgrounds in engineering, science and technical documentation.

Swanson Reed regularly conducts workshops throughout Australia, surveying clients on their strategies for innovation and R&D activities. The R&D Tax Incentive remains an important cornerstone of our client's R&D (especially SMEs), and Swanson Reed has used forums such as this as a medium for devising a practical response to the consultation paper.

Summary of Submission Points

- Swanson Reed commends and supports the introduction of the R&D quarterly credits, which will enhance the ability of many start-up or loss-making companies to fund their R&D activities.
- Where possible, the quarterly credit system should be integrated within a company's Business Activity Statements to minimise compliance burden and consolidate ATO receipts/remittances.
- Allowing companies with no prior history with the R&D Tax Incentive to access the quarterly credit system should be explored, while obviously being subject to more stringent reporting requirements.
- Measures to ensure companies are aware of potential adverse adjustment payments arising from receiving R&D quarterly credits should be implemented to encourage companies to vary their quarterly credit amount accordingly.

The Introduction of R&D Quarterly Credits

Before proceeding with our responses to the specific questions that are raised in the consultation paper, we take this opportunity to commend the general concept of the introduction of the R&D quarterly credits. It has long been suggested by many businesses, that the ability to receive a recoupment of R&D expenditure as it is incurred throughout the year would ease cash flow constraints.

The ability of a company to receive a short-term recoupment of eligible costs also makes the proposition of investing in R&D more attractive and attainable to many businesses in the SME sector.

Technology companies in the start-up phase will also benefit from the system and the enhancement to their working capital stream.

Swanson Reed notes that for the quarterly credit system to operate effectively, timely processing of the credits will be crucial. This timing includes both the registration notification by Innovation Australia and the processing of any funds due by the ATO.

It is the feedback of some businesses that waiting periods for annual R&D tax offsets receivable under the previous R&D Tax Concession regime can sometimes exceed 4 Months. This includes cases where R&D schedules are lodged within the company's initial (not amended) income tax return.

Swanson Reed recognises that the validity checks undertaken by the ATO prior to the release of R&D offsets are a vital mechanism for maintaining the integrity of the R&D tax regimes. However, it is our recommendation that resources within the ATO be increased significantly to ensure adequate processing times and for the quarterly credit system to provide the benefits intended.

Administration of R&D Quarterly Credits

Swanson Reed agrees with the proposed administration of the quarterly credit system as a joint administration between the ATO and Innovation Australia.

The requirement that a company must submit an outline of proposed R&D activities to Innovation Australia for consideration will encourage companies to better plan their R&D activities and the documentation underlying them. The process may also coerce companies to better budget for their R&D activities given the prospect of quarterly inflows of cash throughout the year.

Swanson Reed notes that, per the consultation paper, companies who apply to receive quarterly credits may be subject to subsequent findings by Innovation Australia as to whether the activities are considered to be eligible. We recommend that, where possible, such findings should be made prior to the acceptance of any notification for quarterly credits, to avoid situations necessitating the recoupment of quarterly credits following the issue of adverse findings.

Swanson Reed agrees with the timing of the cut-off date for applications to receive quarterly credits (i.e. the 28th day after the end of the quarter). We also recommend that time frames for the receipt (or crediting) of quarterly credits be structured to correlate with this timing, such that companies' general Business Activity Statement (BAS) obligations are administered in conjunction with the quarterly credits.

Allowing companies to consolidate their reporting for quarterly credits within their BAS would minimise compliance burdens, while also allowing companies to offset any quarterly credits due against their PAYG withholding and GST liabilities.

Swanson Reed also agrees with the proposed requirement for companies to continue to lodge annual registration applications and R&D schedules as a means to reconcile the amount of quarterly credits received throughout a year.

Access to the Quarterly Credit Regime

Swanson Reed recognises that appropriate risk mitigation procedures must be put in place to maintain the integrity of the R&D Tax Incentive and quarterly credit systems.

Accordingly, it is reasonable that companies that are not complying tax payers will be deemed to not have the requisite discipline to access the quarterly credit system.

Swanson Reed would, however, recommend that an option be explored, allowing companies without a history of lodgements within the R&D Tax Incentive regime to be allowed to use the quarterly credit system.

Access for such companies could possibly be subject to:

- The company being a compliant tax payer (or in the case of newly incorporated entities that the directors and their associated entities having a history of ATO compliance); and
- The entity being subject to more rigorous reporting requirements than would normally be required of a company with a history of R&D incentive claims. For example; a company who has no prior R&D tax incentive claim history, but who has obtained an advanced finding by Innovation Australia, may be considered suitable to access the quarterly credit system.

The ability for companies to obtain a recoupment of their R&D expenditure in the short term (rather than having to, potentially, wait for 12–20 month, if claiming the R&D Tax Incentive within their annual returns) may again make the prospect of undertaking R&D activities more attractive to small companies.

It may also increase the attractiveness of investment in start-up companies and lead to the creation of new ventures; i.e. a ‘semi-guaranteed’ and relatively immediate recoupment of R&D expenditure may be a catalyst for the inception of companies that may otherwise not have been able to generate sufficient seed capital.

The above may have spill-over effects and inspire entrepreneurial activity and innovation throughout the Australian economy.

Calculation of the Quarterly Credit Amount and Interaction with Annual Claims

Swanson Reed agrees with the proposition within the consultation paper, that Quarterly Credit amounts be derived from the company's most recent income tax return lodged (i.e. a base year).

We do, however, have a particular concern in relation to situations where a company may have the same or more eligible R&D expenditure as their base year, although be due a significantly less net R&D tax offset, due to other parameters of the company's tax position. An example of such a situation is illustrated below:

	Base Year	***Subsequent Year***
Sales (a)	$5,000,000	$6,000,000
Total Expenses (b)	$5,500,000	$5,000,000
R&D Expenditure Within Expenses (c)	$1,000,000	$1,500,000
Pre R&D Taxable Income (A-B)	($500,000)	$1,000,000
Add Back R&D claimed as Offset (c)	$1,000,000	$1,500,000
Adjusted Taxable Income	$500,000	$2,500,000
Income Tax Payable on Above (30%)	$150,000	$750,000
Credit for R&D Tax Offset (C*45%)	($450,000)	($675,000)
Add Quarterly Credits Received Throughout Year	-	$300,000
Net Tax Payable (Refundable) Alongside ITR	($300,000)	$375,000

Swanson Reed acknowledges that companies will, indeed, have use of funds derived from Quarterly Credits throughout a year and not be subject to general interest charges (GIC), if any requisite adjustment payments are paid on time. However, the reception of funds from quarterly credits may present companies with the temptation to spend, invest, or return the funds to shareholders, and not be in a position to attend to adjustment payments upon lodgement of their annual income tax returns.

Companies must, therefore, exercise financial discipline when receiving quarterly credits under both 'Safe Harbour' and varied amount methodologies, and understand that the net R&D tax offsets receivable within their annual income tax returns are a culmination of all of the following variables:

- R&D expenditure for the current year;
- Profit/taxable income for the current year; and
- Availability of any tax losses carried forward from prior years.

Swanson Reed recommends that, as part of the compliance process for lodging and receiving quarterly credits, companies should be required to self assess the interaction of the above factors, especially when transitioning out of start-up/tax-loss phase. This would assist companies to determine whether the amount of a quarterly credit for a particular quarter was suitable, and if not, to vary the quarterly credit accordingly.

Please contact us if you would like to discuss any aspect of this submission.

Yours sincerely

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