

Ai GROUP'S
BUSINESS RESEARCH & DEVELOPMENT
SURVEY
JUNE 2010

For the fortnight beginning 7 June 2010, Ai Group invited members to participate in an on-line survey on the Government's proposed new research and development tax incentive.

Legislation that would give effect to the Government's proposed new R&D tax incentive is currently before the Parliament. It contains fundamentally new eligibility rules governing the research and development tax incentive.

Responses were received from 122 businesses across a wide range of Ai Group's membership including in the manufacturing, construction, ICT, transport & logistics, utilities and services sectors. Smaller businesses were well represented with 54 of the respondents having less than 50 employees.

Overview

Ai Group's survey clearly indicates the changes proposed by the Government will be detrimental to the level of business R&D.

The changes the Government is attempting to rush through the Parliament at this late stage will be highly disruptive for the many businesses with R&D projects planned for the 2010-11 year.

Compliance costs associated with the tax incentive are set to rise if the Government's proposed changes are legislated.

At the heart of the problems anticipated by business is a fundamental misunderstanding on the part of the Government of the nature of business R&D.

In contrast to the Government's narrowly-focussed conception of breakthrough, laboratory-based research, the survey clearly shows:

- That a large proportion of business research and development relates to the application of existing knowledge in new ways; and
- An even larger proportion is undertaken in the production environment or is directly related to production.

The Government's approach does not match real-world business practice.

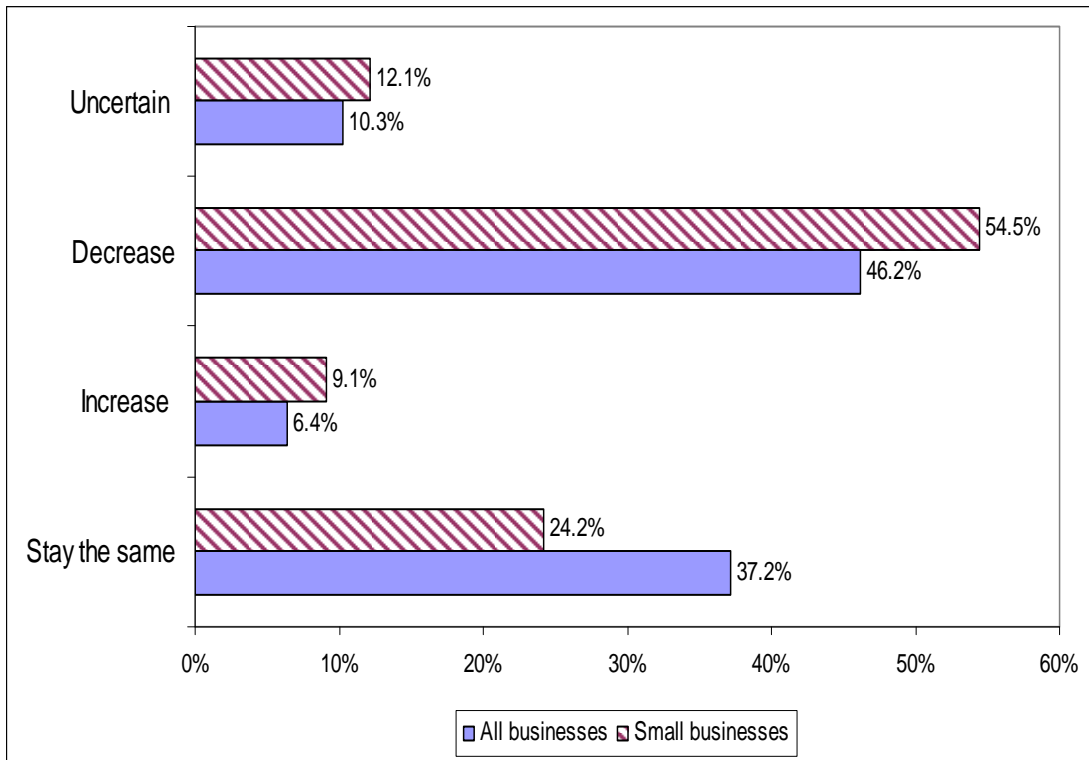
Key Survey Results

Impact on Level of R&D

Well over four in ten (46.2%) businesses that currently use the tax incentive expect the level of their R&D spending would fall as a result of the changes proposed by the Government. Only 6.4% of businesses expect their R&D spending would increase.

A larger proportion (54.5%) of smaller businesses currently using the tax incentive had an expectation of a lower level of R&D. Around 9% of smaller businesses reported an expectation of higher R&D spending if the Government's changes are introduced.

Question: *Do you expect the overall level of R&D activities you will undertake as a result of the Federal Government's proposed R&D tax credit scheme to increase, decrease or stay the same?*



Re-evaluation of 2010-2011 R&D Projects

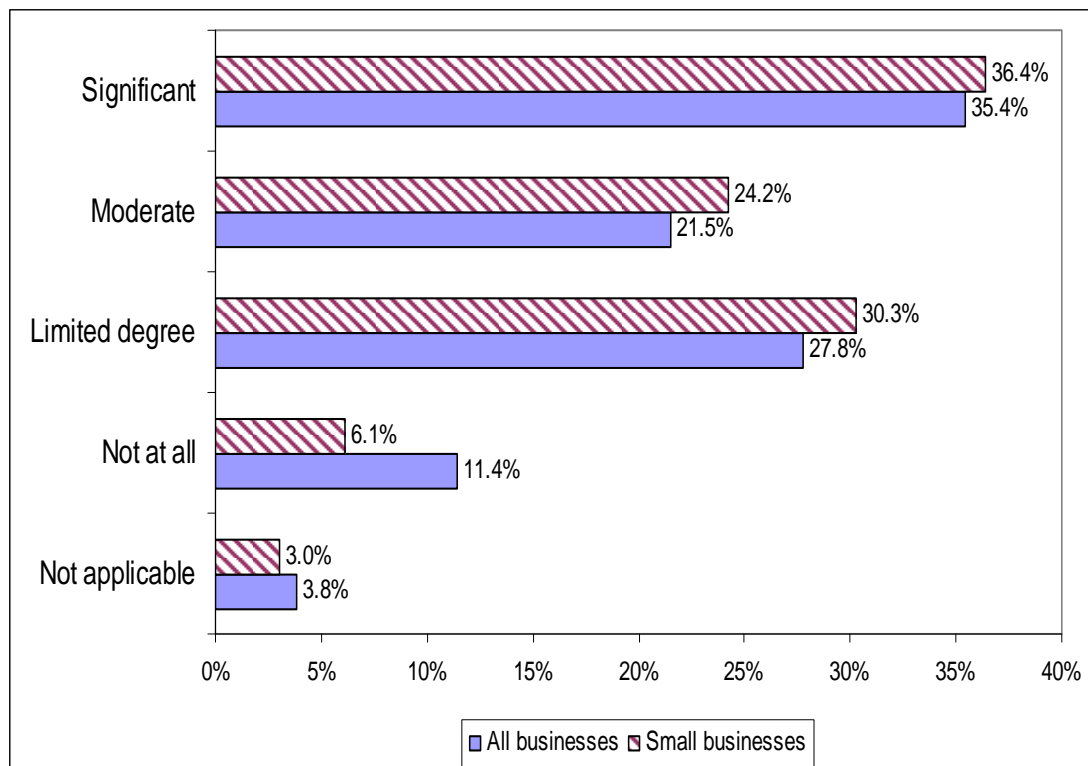
The proposed changes to R&D would leave businesses with less than two weeks to prepare for the new regime if it is legislated.

We asked businesses who currently claim the tax incentive about the extent to which they would need to re-evaluate their R&D projects if the new scheme was to commence from 1 July 2011.

For all businesses, over one-third (35.4%) of respondents said that they would need to undertake a significant re-evaluation of their existing plans. A total of 84.7% of respondents indicated that they would need to re-evaluate their existing plans to some extent.

Smaller businesses were slightly *more* likely to report a need to re-evaluate existing plans with 36.4% reporting a need to undertake a significant re-evaluation and a total of 90.9% reporting that they would need to re-evaluate their existing plans to some extent.

Question: *To what extent will your company have to undertake a re-evaluation of R&D projects for the next financial year should the new R&D tax credit scheme be introduced on July 1?*



Impact on Compliance Costs

We asked businesses to compare the expected compliance costs of the new approach with those associated with the current R&D tax arrangements.

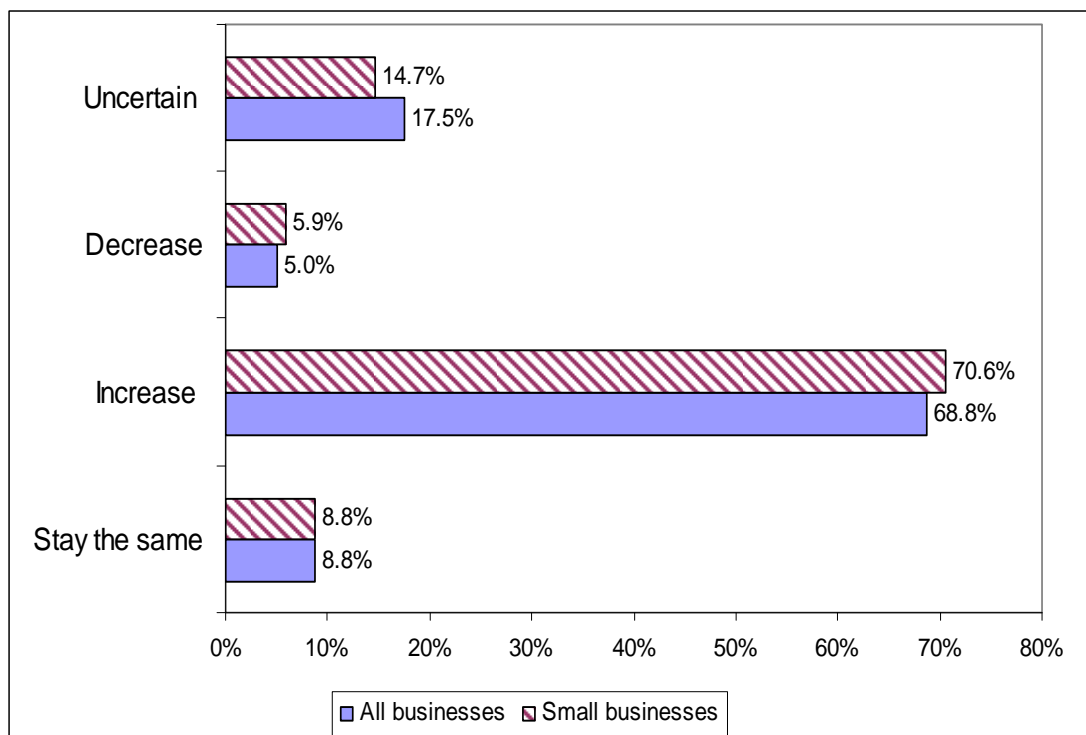
Rating of Current Compliance Costs

	All businesses	Smaller businesses
Low	1.3%	1.9%
Moderate	33.8%	34.6%
High	53.8%	50.0%
Very High	11.3%	13.5%

Of all businesses that currently use the tax incentive 65.1% rated the compliance costs of the existing arrangements as “high” or “very high”. A similar proportion of smaller businesses (63.5%) rated the compliance costs of the existing arrangements as either “high” or “very high”.

Over two-thirds (68.8%) of all businesses that currently claim the tax incentive expect that compliance costs would rise as a result of the Government’s new tax incentive. The proportion of smaller businesses expecting compliance costs to rise is 70.6%. A further 17.5% of all businesses are uncertain about the impact and only 5% of all businesses (and 5.9% of smaller businesses) expect compliance costs to fall.

Question: *Do you believe the compliance requirements for the new R&D tax credit scheme will decrease, increase or stay the same compared to the current tax concession?*



The nature of business research and development

The survey also asked businesses about the nature of their R&D activities. The purpose of this was to assess the degree to which current R&D activities were conducted for the purpose of generating new knowledge (and which would therefore qualify under the new definition of “core R&D”) or were new applications of existing knowledge. The latter would not qualify under the proposed definition of core R&D.

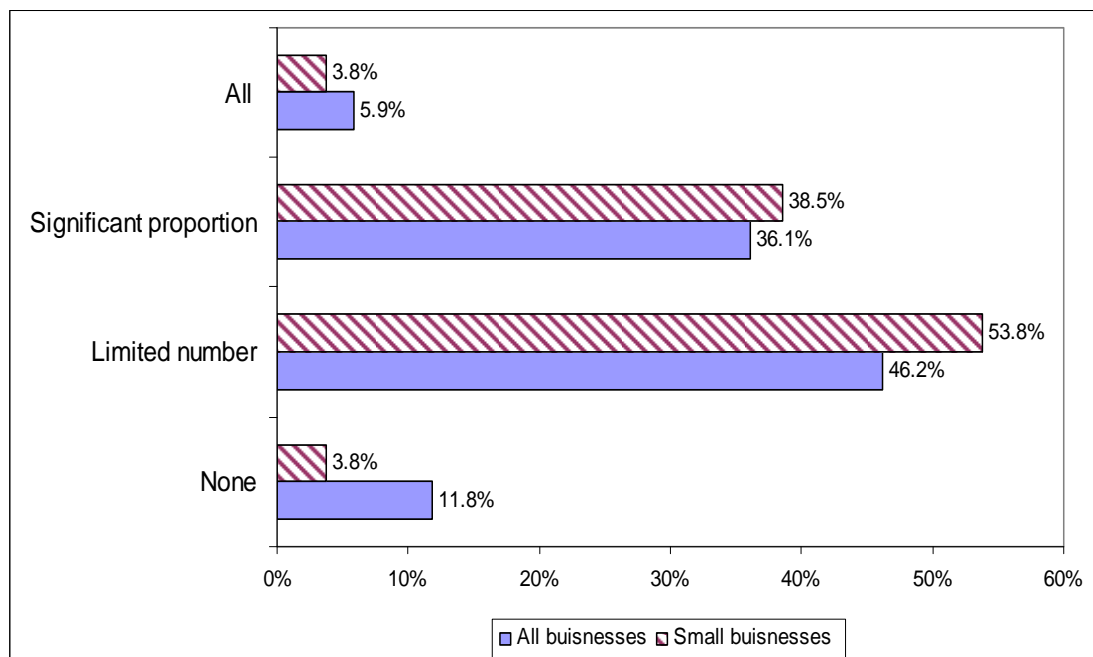
We were also keenly interested in whether businesses R&D activities were carried out in the production environment or were directly related to production. Under the Government’s proposals, for most business R&D such R&D would be discriminated against under the “dominant purpose” test with the considerable risk that these R&D activities would not qualify as supporting R&D and therefore would not be eligible for the tax incentive.

Is business R&D undertaken to generate “new knowledge”?

Of all businesses responding to the survey, 11.8% said that none of their R&D activities were undertaken for the purposes of generating new knowledge and 46.2% said that only a limited number of their R&D activities were undertaken for the purposes of generating new knowledge.

For smaller businesses, the proportion indicating that none of their R&D was for the purpose of generating new knowledge (3.8%) was lower than for the total sample while for 53.8% of these businesses only a limited number of their activities were for the purpose of generating new knowledge.

Question: *To what extent are your R&D activities conducted for the purpose of “generating new knowledge”?*

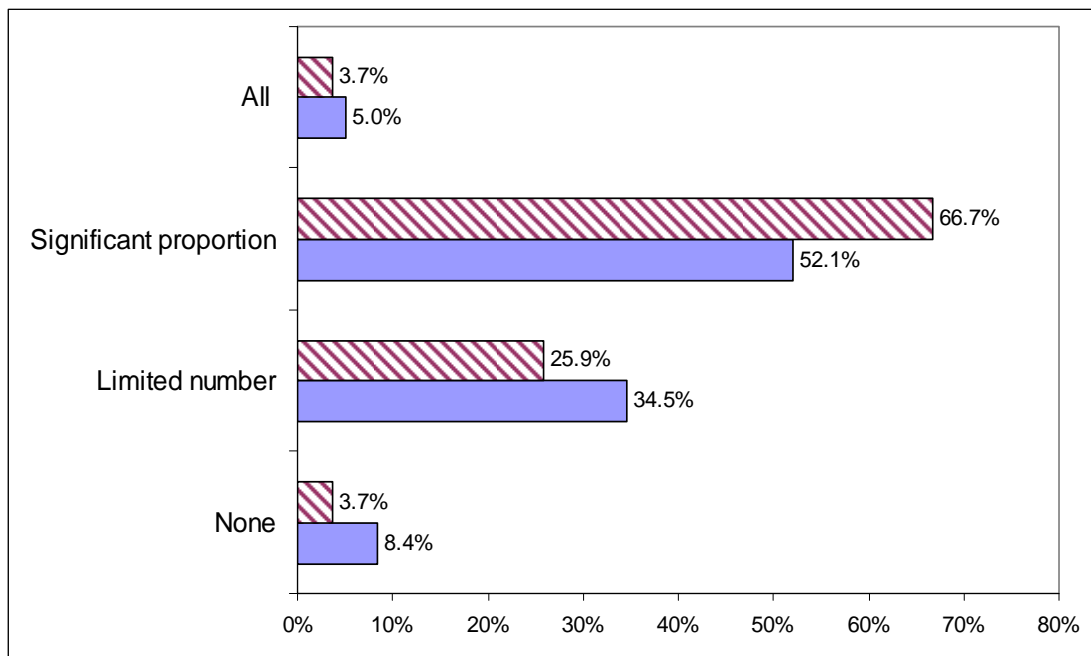


Or is business R&D more applying existing knowledge in new ways?

Of all businesses responding to the survey, 52.1% said that a significant proportion of their R&D activities were not related to generating new knowledge but, rather, were new applications of existing knowledge while a further 5% said all of their R&D activities involved applications of existing knowledge.

For smaller businesses, 3.7% said all of their R&D activities involved applications of existing knowledge and did not generate new knowledge while two-thirds of smaller businesses said that a significant proportion of their R&D activities involved applications of existing knowledge.

Question: *To what extent are your R&D activities not conducted for the purpose of generating new knowledge but applying "existing knowledge in new ways"?*

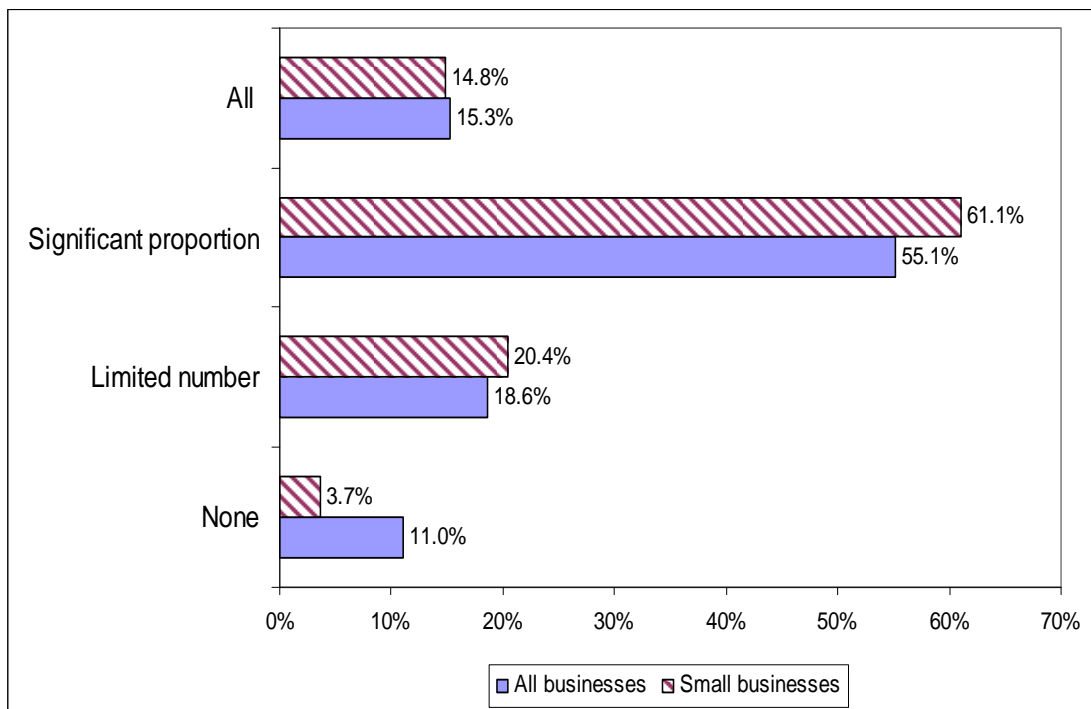


Business R&D and the production environment

Of all businesses responding to the survey, over 70% said that all or a significant proportion of their R&D activities were carried out in the production environment or were directly related to production.

Of smaller businesses, 75.9% said that all or a significant proportion of their R&D activities were carried out in the production environment or were directly related to production.

Question: *To what extent are your R&D activities carried out in the production environment or directly related to production?*



The last-minute change proposed by the Government to remove the dominant purpose test for smaller businesses may provide these businesses with a reprieve from this onerous requirement, but it will clearly not do so for medium-sized and larger businesses.

Further, this last-minute change will not assist the many smaller businesses who will find that none of their expenditure is eligible for the R&D tax incentive because their R&D relates to the application of existing knowledge and is not undertaken for the purpose of generating new knowledge. For these businesses, the decision to remove the dominant purpose test for some businesses will not provide any benefit.