

17 June 2021

Consultation Manager
Software development activities and the R&D Tax Incentive
R&D Tax Incentive Branch
Department of Industry, Science and Technology
GPO Box 2013
Canberra, ACT, 2601

Via Email: RDTI.Engagement@industry.gov.au

Dear Sir/Madam,

Software development activities and the R&D Tax Incentive

The Australian Investment Council welcomes the opportunity to contribute to the Department of Industry, Science and Technology's consultation process on the guide to *Software development activities and the R&D Tax Incentive*.

As Australia emerges from the COVID-19 pandemic and transitions to an economy driven by technology and innovation, the development of new software will be central to underpinning new businesses and industries, and enhancing existing ideas that will see Australia re-emerge as a highly skilled, knowledge-based economy.

To support this transition, our economic recovery, and Australian jobs, it is vital that businesses are able to effectively and confidently invest in new ideas and new processes. Software development within the Research and Development Tax Incentive (**RDTI**) framework is one avenue where government can assist businesses invest in the future of our nation and create new Australian jobs.

A strong, robust and consistent Research and Development (**R&D**) scheme is important for maintaining the confidence of Australian businesses and entrepreneurs to invest in the future of our nation. Efficient access to R&D is also vitally important for enabling billions of dollars of investment capital to flow into Australian start-up and early stage businesses. These are the businesses that are the foundation for Australia's future growth through employment and economic contribution.

The Australian Investment Council is supportive of comprehensive, clear and predictable guidance on software within the RDTI framework that clearly outlines circumstances where Australian entrepreneurs can confidently access the incentive to progress the development of their businesses and innovation ideation.

However, in our view some aspects of the current draft guidance for software are unclear in respect of:

1. How the examples provided can be specifically applied to software;
2. Where the distinction is drawn between the RDTI guidance and the software guidance; and
3. What criteria are essential for a successful software R&D claim.

The potential impact of the guidance in its current form could be to disincentivise, rather than encourage, early stage and fast-growth businesses that genuinely fit the requirements for an RDTI software claim from applying due to the lack of clarity in certain areas of the guide.

The Council's recommendations on the draft guidance for software development are set out below. The Council encourages the Department to carefully consider the recommendations in respect of the long-term outcomes for the nation.



We look forward to participating in future discussions on the guidance for software development activities and the RDTI. If you have any questions about the recommendations or any specific points outlined in this submission, please do not hesitate to contact me directly via email at ceo@aic.co or Brendon Harper, head of policy and research, on the phone at 02 8243 7000.

Yours sincerely

Yasser El-Ansary
Chief Executive



Overview

The Australian Investment Council is the voice of private capital in Australia. Private capital investment has played a central role in the growth and expansion of thousands of businesses and represents a multi-billion-dollar contribution to the Australian economy. Our members are the standard-bearers of professional investment and include: private equity, venture capital and private credit funds, alongside institutional investors such as superannuation and sovereign wealth funds, as well as leading financial, legal and operational advisers.

Private capital fund managers invest billions of dollars into Australian companies every year. Funds under management of Australian-based private capital funds exceeded \$37 billion in 2020, testament to the growth in available capital to support investment into businesses across every industry sector of the economy. Private capital investment offers smart, patient capital to privately backed companies along with expert guidance and strategic support.

More and more businesses are choosing to raise capital from private investors, rather than through public markets, because of the benefits of partnering with venture, private equity and private credit firms. Private capital investors can help unlock the growth and expansion opportunities of businesses through active asset management in a way that public markets simply cannot. This is evidenced by the fact that private capital-backed Australian businesses generate 1 in 9 new Australian jobs and contribute 2.6 per cent of Australia's GDP.¹

Australian business investment in innovation is estimated at \$32-36 billion annually, or 1.9 per cent of GDP in 2016-17, of which about half is R&D (\$16.7 billion in 2015-16, and \$17.4 billion in 2017-18).² This investment generates economic benefits for the investing firms and their customers in the form of new/improved products and lower prices. It is also recognised by the OECD that businesses who invest in research are generally more productive, with turnover growth for high R&D intensity firms between 5.9 to 7.3 times higher than low R&D intensity firms.³

Many companies in the innovation ecosystem are actively engaged in software development which is critical for the creation of new products, services and industries. For example, new software is being deployed in the gaming industry: to trade non-fungible tokens for virtual items such as digital art; and for the evolution of fintech companies: as payment platforms and providers of financial services.

Clear and accessible guidance for software development activities within the RDTI framework is an essential element of the innovation and tax system to drive innovation in businesses supported by new technologies in areas such as FinTech, cyber security, food technologies and health and medical services. The refreshed software guidance is a positive step towards providing information specific to the software sector to encourage innovation and to support future jobs and industries.

A number of recommendations relating to specific aspects of the consultation are set-out in the submission below. These recommendations are largely aimed at reducing uncertainties for the target users of the guidance.

¹ Deloitte Access Economics (April 2018) *Private Equity: Growth and innovation*

² AlphaBeta, (January 2020) *Australian Business Investment in Innovation*,

³ Department of Industry, Science, Energy and Resources, *Australian Innovation System Report*, 2017.



1. Purpose of the Guide

The *Software development activities and the R&D Tax Incentive (the Guide)* is a positive step towards assisting stakeholders in understanding how the RDTI framework applies to software development. In its current form, the Guide appears to be directed to advisers and practitioners rather than to the taxpayers who may be considering making a claim. The examples outlined below are based on the users of the guide being predominantly the businesses or individuals seeking guidance on the processes and requirements for making an eligible software claim under the RDTI framework.

Recommendation 1: *Target the guidance at taxpayers who may be seeking to make a claim*

The Council recommends the Guide is simplified in terms of language and content to provide holistic “how to” guidance for claimants on the process for making an RDTI software claim from eligible and excluded activities, to preparing a claim.

2. Structure of the Guide

It is important to ensure that the reader – the person or business who will be lodging the claim – has a clear understanding of the process and expectations. This could be partially achieved through relocating some of the content. For example, the third paragraph on page 3 beginning “*This guide provides an overview of the...*” could be moved to *About This Guide* on page 2.

Providing the user of the guide with streamlined summaries and illustrations would also assist in achieving greater clarity in the guide. Examples include:

- Under *Software development and R&D activities* on page 3, insert a simple summary explanation in the introductory paragraph of how claims for software development and R&D works. Include a Plain English explanation/glossary with the meaning of:
 - *Eligible R&D activities;*
 - *Core R&D activities;*
 - *Supporting R&D activities;*
 - *Hypothesis (with a business rather than science focus); and*
 - *Experiments (with a business rather than science focus).*
- Include a diagram to illustrate the process for a software claim for eligible activity from registration, to forming a hypothesis, determining novel software activity, developing an experiment, recording the progression of work, and to making a claim.

Recommendation 2: *Reconfigure the structure of the Guide to provide more clarity for users*

The Council recommends the Guide is restructured to include simple explanations of key R&D terms and an illustration that sequentially shows the process from submitting an application to making a claim.

Distinguish between software guidance and the Guide to Interpretation

While the content in the Guide is intended to be used in conjunction with the RDTI *Guide to interpretation* it is not clear in places as to where the distinction is drawn between both documents. For example, if the intent of the guide is to provide “an overview of R&D activities and examples to help you self-assess your software development activities,” information specific to software development needs to be applied throughout the entire document. It might also be helpful to the reader to indicate where the content in the software guide has been taken from the *Guide to Interpretation* to avoid any confusion that the information is new or existing.

Supporting R&D activities on page 6 of the guide seems to revert to the *Guide to Interpretation* definitions. More clarity could be achieved in this section by a relevant example for software development. The section on *Software development methodologies*, also on page 6, provides some explanation for the systematic progression of work as it applies to software, then goes on to discuss core R&D activities and supporting R&D activities and then back to core activities. This could be



confusing to the user regarding what is and what is not eligible for software development claims. To reduce confusion, the systematic progression of work for software could be linked back to the same heading on page 4 with a software specific example.

Recommendation 3: *Make the content more software specific*

The Council recommends sections of the Guide that repeat the *Guide to Interpretation* are removed where relevant and replaced with guidance specific to software.

3. Further guidance to assist businesses in assessing eligibility

Include more examples on eligible activities for software

While the Guide has progressed efforts to illustrate examples of how software applies to R&D eligibility under the RDTI framework, the end user would greatly benefit from examples specific to software claims across a range of applications. For example, the *Necessary expenditure* example on page 12 of the Guide could be software specific rather than an example that is more relevant to the *Guide to Interpretation*.

Recommendation 4: *Include more examples of eligible activities*

The Council recommends more examples are included in the Guide to illustrate how the RDTI is applicable to successful software claims.

More clarity needed on experiments for software

The narrow interpretation of “experiments” in the RDTI legislation has caused a considerable amount of confusion amongst software claimants. However, the Moreton Resources case tested the interpretation of the new use of technology for R&D and clarified the meaning of experiment in a business context. This has application in particular to software eligibility under the definition of “experiments” in the Tax Act.

Recommendation 5: *Further guidance and clarity on eligibility of experiments and software*

The Council recommends further guidance, including case studies and reference to case law be included in the Guide to assist companies assess their eligibility for the RDTI and software claims.

Case study

While the Far Side Case study on pages 7 to 10 outlines the key points for consideration in an R&D claim, it would be beneficial to users if the case study is presented in a way that is consistent with the requirements of the new R&D portal.

Recommendation 6: *Present the Case Study so it is consistent with the R&D Portal*

The Council recommends the Case Study is presented in a consistent manner with registration under the new R&D Portal coming into effect on 1 July 2021.