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5th February 2007

Science and Innovation Study
Productivity Commission
PO Box 80
Belconnen ACT 2616

Dear Sirs,

Re: **Public Support for Science and Innovation: Productivity Commission Draft Research Report**

We refer to the Productivity Commission Draft Research Report released on 2 November 2006 and the recommendations contained therein which may impact the Research and Development (R&D) Tax Concession in Australia.

Of interest to Integrated Research Limited are proposals contained within Chapter 9, "Business Programs" that propose changes to the base R&D Tax Concession – a move which challenges the viability of conducting labour intensive research and development activities in Australia.

This document outlines matters of concern to Integrated Research Limited, and includes:-

The Draft Report contains a proposal to move away from the 125% Base R&D Tax Concession because it is available to all eligible firms whether or not the R&D would have been performed without it. We believe this particular proposal is flawed in its assessment and suggests an inappropriate understanding of the decision processes for organisations undertaking commercially focussed research and development. Further, movement away from the base R&D tax concession will add to the systematic erosion of the tax concession's effectiveness since its implementation in 1985.

Australia has a highly regulated and bureaucratic system for dealing with, and the reporting of, activities that involve research and/or development. Currently, the complexities include the basis of recording research and/or development activities for accounting, taxation and Australian Bureau of Statistics requirements. Going forward, it is our request for these disparate requirements become more closely aligned as a means to simplify the reporting burden imposed upon commercial enterprises.

Realignment of the R&D tax concession towards the R&D Premium has merit. However, the current process for accessing the Premium is cumbersome and full access to the 175% deduction is not attainable to many longstanding applicants. Should the access criteria be amended, we envisage further difficulty to accessing the full 175% Premium and accordingly we request that your recommendations include making full access to be simplified. When the Premium deduction was introduced the Senate Committee discussing them were acquainted with the difficulties. The proof of the difficulties is evidenced by what has transpired since that time.

Removal of the base R&D tax concession will have a significant impact upon companies undertaking R&D in highly labour intensive industries such as software development. Accordingly, given current exchange rates, reduction of *(or removal of)* the base R&D concession may force company's such as Integrated Research Limited to seriously consider relocating R&D activities to countries with more favourable forms of assistance for R&D activity. Therefore, we request the Productivity Commission to seriously reconsider any proposal to move away from the base R&D concession.

Should you require further information, please do not hesitate to contact our office on 02 9966 1066.

Yours sincerely
David Purdue
Commercial Manager

Company Overview

Integrated Research Limited is a publicly listed company (ASX[1] code: IRI) with a heritage since 1988 of developing and marketing performance monitoring software for business-critical computing and IP Telephony environments. The company operates its global headquarters from North Sydney and services customers in more than 50 countries through direct sales offices located in the USA, Europe and Australia, and via a global channel-driven distribution network. Customers comprise 35% of the Global 1000 companies and include the world's largest: - bank, telecommunications company, stock exchange, computer hardware manufacturer and Internet service provider.

To achieve its business success, IRI has focused upon the international commercialization of its PROGNOSIS products whilst investing heavily *(and continuing to do so)* in Australian based research and development activities. Accordingly, during the financial year ended 30 June 2006, research and development expenses *(for accounting purposes)* were $6.68 million, representing 19% of revenue, up from 18% in 2005. All but a small percentage of research and development is conducted directly by the company in Australia, where IRI employs in total some 88 of its 128[2] global employees. IRI has been profitable since 1995 with sales of software licenses and maintenance to customers outside of Australia continuing to exceed 90% of total revenue earned. This has resulted in the company receiving several export recognition awards throughout its history. IRI is a company bringing revenue and recognition to Australia. Clearly, the company's activities have provided a net benefit to the Australian economy. Throughout its life, IRI has received government assistance from various incentive programs, which include the R&D Tax Concession.

Productivity Commission Draft Research Report and the R&D Taxation Concession

The Draft Research Report (the Report) raises several concerns for Integrated Research. In particular, the proposal to move away from *"the basic R&D tax concession because it is available to all eligible firms whether or not the R&D would have been performed without support"*[3] has the potential to reduce the viability/incentive for international businesses to continue undertaking specialized R&D activity in Australia, rather than in other countries. Further, the proposal to *"rebalance the tax concession away from the generally available 125 percent component towards the 175 percent incremental component"*[4] *(assuming all else remains the same)* could unwittingly harm established claimants such as IRI and is a short-sighted proposal. Ultimately, these proposals have the potential to harm the viability of highly labour intensive R&D activities in Australia.

Since inception in 1988, IRI has considered the R&D Taxation Concession an important component of the company's business investment strategy. However, over this time the R&D tax concession's impact on the company's R&D activities has been systematically eroded by changes in government policy which has lowered the base concession from 150% to 125%. When combined with changes in the corporate tax rate from 46% to 49% to 39% to 33% to 36% to 34% and to the current 30%, the effective tax reduction for eligible R&D activities covered by the basic R&D concession has diminished somewhat from a maximum 73.5% [5] in 1988 to 37.5% [6] in 2006. Going forward, any proposal to further reduce the basic concession's effectiveness will impact IRI's ability to remain *(globally)* competitive whilst maintaining significant R&D activities in Australia. This may mean a decision to move our R&D activities off-shore. We are sure the Productivity Commission has heard that line of argument many times before. However, where IRI's business is so globally oriented, where the costs of developing software in other countries is becoming more and more competitive and efficient, then the thing that will keep our business in Australia will be the tax concessions that go to encourage R&D activities in Australia. In truth, we believe that IRI is

[1] ASX – acronym for the Australian Stock Exchange.
[2] Refer Integrated Research Limited, Annual Report 2006, page 12.
[3] Public Support for Science and Innovation: Productivity Commission Draft Research Report, November 2006, Chapter 9, Business programs, page 9.1
[4] Public Support for Science and Innovation: Productivity Commission Draft Research Report, November 2006, Chapter 9, Business programs, page 921
[5] In 1988 the R&D Tax Concession was 150% and company tax rate was 49%. Hence - 150% x 49% = 73.5%.
[6] In 2006 the basic R&D Tax Concession is 125% and company tax rate is 30%. Hence – 125% x 30% = 37.5%.

following the spirit of the R&D legislation by conducting R&D in Australia. It is not clear that the Commission's recommendations have the original legislation's thrusts of growing our knowledge base, import replacement and export enhancement in mind. The spread and backwash effects and the multiplier effects of undertaking business R&D in Australia are very large. They need to be carefully considered in reaching your formal conclusions.

Research and Development activity – definitional complexities

The R&D Tax Concession is a highly regulated and bureaucratic program for applicants to administer. In particular, regulations surrounding eligibility for accessing the R&D Premium are complex and require ever increasing year-on-year levels of R&D expenditure – an outcome which is not sustainable over time due to normal changes in the economic and business cycles that are faced by applicant companies. Accordingly, should the base 125% R&D Tax Concession be removed with only the R&D Premium remaining[7], significant claimants such as IRI and other large claimants of the tax concession could be unwittingly disadvantaged in years when R&D activity *(for taxation purposes)* may be reduced due to economic downturns or changes in business priorities. Further, R&D Premium calculations can be affected by: - whether activities undertaken during each particular year continue to meet the definition of R&D that is applied for Income Tax; and also the locale of activity undertaken.

Currently, businesses operating in Australia are confronted with three (3) definitions and alternative treatments for activities that constitute research and/or development. These cover the areas of Financial Reporting, Income Tax and reporting to the Australian Bureau of Statistics. As a public company that is required to report annually to its shareholders & ASX, the Australian Taxation Office, plus the Australian Bureau of Statistics, IRI is continually faced with R&D definitional challenges. Consequently, R&D activities which are defined as being eligible under one reporting mechanism may not meet the definitional requirements of another reporting mechanism. Therefore, suggesting changes to the base R&D tax concession will add yet another level of complexity to the legislation process that deals with R&D undertaken in Australia. Accordingly, rather than suggesting changes likely to increase complexity, the Productivity Commission could assist by proposing amendments aimed at simplifying the R&D bureaucratic maze.

Reporting of R&D in Australia

A company's R&D activities will change from year to year with changes in business and economic cycles. Consequently, it is likely the eligibility of activities under each of the definitions will vary – depending upon the format of research and/or development undertaken and the location thereof. Activities that are eligible for accounting purposes may be excluded for taxation purposes *(and vice versa)*. As a consequence, there will be an impact upon a company's ability to access the basic R&D taxation concession and/or the R&D Premium in a particular year. For a reporting entity company, the three alternative treatments for research and/or development are:-

1. Financial Reporting. For reporting entities, the treatment of R&D activities and expenditure is covered by Australian Accounting Standard AASB 138 *Intangible Assets* which applies to annual reporting periods beginning on or after 1 January 2005[8]. Using AASB 138 there is a definition for *Research* and a separate definition for *Development*, with the costs associated with each activity being treated differently.

   Research is defined as "original and planned investigation undertaken with the prospect of gaining new scientific or technical knowledge and understanding".[9] During the research phase, no intangible asset is recognized and expenditure on research is expensed to the reporting entity's profit or loss when it is incurred.[10]

[7] It is assumed, that if the R&D base concession were to be removed, all else involving eligibility criteria and calculations for the R&D Premium would remain the same as they are currently.

[8] Australian Accounting Standard AASB 138 *Intangible Assets*, Issued December 2004

[9] Australian Accounting Standard AASB 138 *Intangible Assets*, Issued December 2004, Definitions, paragraph 8

[10] Australian Accounting Standard AASB 138 *Intangible Assets*, Issued December 2004, Research Phase, paragraph 54

Development is defined as "the application of research findings or other knowledge to a plan or design for the production of new or substantially improved materials, devices, products, processes, systems or services before the start of commercial production or use.[11] Subject to six (6) criteria, *(which include the expectation of future economic benefits attributable to the asset and reliable measurement of the asset costs)* an asset created during the development phase can be capitalized *(deferred)* to the Balance Sheet and recognized as an intangible asset.[12] Once the intangible asset becomes available for use *(i.e. commercial production has commenced)*, capitalized development costs can be amortized to the company's Profit or Loss over the intangible asset's useful life[13]. However, if the intangible asset's useful life is indefinite there is no amortization charge.

For accounting purposes, an R&D project's success is based on economic return, rather than technical/legislative grounds which apply under the taxation legislation. Accordingly, reporting entities must consider the likely economic outcome of a project before such determination can be correctly assessed. For accounting purposes, there is no restriction on whether the R&D project is undertaken in Australia or overseas.

2. Income Tax. The taxation treatment of R&D expenditure is outlined in section 73B of the Income Tax Assessment Act 1936 (ITAA). This section operates with guidance from various Income Tax Rulings, the IRDB Act[14] and IRDB Guidelines.[15] Unlike AASB 138, the taxation definition of R&D is more precise and requires activities to be undertaken by an eligible company on its own behalf in Australia or in an external territory.

   Unlike AASB 138, the ITAA section 73B definition combines "research and development" to mean systematic, investigative and experimental activities that involve innovation or high levels of technical risk. For software projects *(such as those undertaken by IRI)* to be eligible for the tax concession, there is an additional requirement for claimant's to have the intention for commercialization to two (2) or more non-associates of the company[16] – this only applies to projects where software development is the project's core element. Consequently, core software developed for a company's internal use is not eligible for the taxation concession whereas a core hardware project *(such as an appliance which may have software embedded inside it)* developed for a company's internal use will be eligible.

   Unlike the accounting treatment, the taxation treatment allows all eligible Research and Development activity to be expensed *(collectively)* in the year the expenditure is incurred. This is a critical issue in the annual commercial planning for a company and results in significant timing differences between the accounting and taxation treatments for some costs. For Research projects, costs are expensed in the year incurred for both accounting and taxation purposes - hence *(other than the permanent adjustment for the tax concession)* there should be no timing difference. However, a Development project's costs often result in substantial timing differences as such expenses are capitalized for accounting but expensed *(plus have the tax concession uplift applied)* for taxation in the year incurred. The accounting and taxation treatment of R&D are critical for reporting entities, because it is businesses in Australia that are conducting significant levels of R&D that have real long term commercial outcomes. R&D conducted by academic institutions and some other government departments *(for example Universities, the CSIRO or the DSTO)* are frequently undertaken without regard to commercialization. We are concerned that the lack of reference to the accounting/tax treatment issues of R&D undertaken by companies in the Commission's report suggests that this important issue of commercial exploitation and benefit for Australia's economy may have been overlooked.

[11] Australian Accounting Standard AASB 138 *Intangible Assets*, Issued December 2004, Definitions, paragraph 8

[12] Australian Accounting Standard AASB 138 *Intangible Assets*, Issued December 2004, Research Phase, paragraph 57

[13] "Useful Life" is: - (a) the period over which an asset is expected to be available for use by an entity; or (b) the number of production or similar units expected to be obtained from the asset by an entity. Refer:- Australian Accounting Standard AASB 138 *Intangible Assets*, Issued December 2004, Definitions, paragraph 8

[14] Industry Research and Development Act 1986 (IRDB Act)

[15] Industry Research and Development Board Guidelines (IRDB Guidelines)

[16] Income Tax Assessment Act – Section 73B(2A)

3. Australian Bureau of Statistics (ABS). The ABS utilises a further definition which is termed "business Research and Experimental Development"[17]. Generally, this involves investigative work which has actual or potential use in the development of new or enhanced materials, products, devices, processes or services and must contain an appreciable element of novelty and the resolution of scientific and/or technological uncertainty (which requires an element of risk to be present). [18] For ABS, the reference is to "business" with no apparent requirement for the business to be either a "reporting entity" *(AASB 138 requirement)* or a "company" *(ITAA section 73B requirement)*.

   There are differences between the ABS definition and eligibility requirements and those for taxation compliance. For ABS these include:- R&D performed by all types of businesses *(irrespective of the amount of R&D expenditure and source of funding)*; computer software development *(irrespective of development for internal use or multiple sale)*; inclusion of non-specific general overhead expenditure, inclusion of research into the social sciences, arts and humanities. For ABS purposes there is also a restriction to Australian-based activities. One of the major reasons for differences between ABS data and the definitions for accounting and taxation is that ABS data is used to report information to the OECD. Whilst reporting to the OECD is important for international comparisons of data, this requirement does place an additional administration burden on those undertaking R&D in Australia.

Going forward, it is our request for simplification of the regulations and bureaucracy to report R&D activities in Australia to meet statutory reporting obligations. In particular, this could be addressed by progressing towards a closer alignment of the reporting requirement needs of the ABS (and the definitions used by the ABS) with those of either Australian Accounting Standard AASB138 or alternatively section 73B of the ITAA.

The R&D Tax Concession Premium

The 175% Tax Concession Premium commenced from 1 July 2001 and entitles company's that have increased the level of R&D expenditure *(for certain items of expenditure)* above the average of the previous 3 years to an additional 50% taxation deduction – thereby increasing the base R&D concession rate from 125% to a maximum of 175%, although obtaining the full 175% deduction is difficult.

For successful international companies operating in labour intensive industries, such as IRI's software development activity, the base R&D tax concession is a significant factor to justify *(in an economic sense)* continuation of base R&D activities in Australia. Access to the R&D Premium provides a further incentive to undertake R&D in Australia. At the full rate of 175%, the R&D premium goes some way towards restoring the R&D tax concession's value that has diminished over time via successive changes to the company tax rate and reduction in the base R&D tax concession from 150% to 125%. *Refer to Appendix 1 for changes to the company tax rate and R&D tax concession since 1985.* However, in many situations claimant companies often find it difficult to meet the qualification criteria for the full 175% Premium and, year-on-year, are more likely to receive only a part thereof which is usually considerably less than 175% – *Refer to examples 1 & 2* below.

Example 1:
Assume a company, *ABC Ltd*, has a history of R&D expenditure of $6,000,000 *(Y0)* for current year and $5,000,000 *(Y-1)*, $4,500,000 *(Y-2)* and $4,000,000 *(Y-3)* for the previous three years. For taxation purposes, all of the expenditure meets the definition of eligible R&D expenditure and is summarized as:-

[17] Australian Bureau of Statistics, Survey of Research and Experimental Development, Business 2004-05, Definitions
[18] Australian Bureau of Statistics, Survey of Research and Experimental Development, Business 2004-05, Definitions

Y0 (current year) Incremental R&D Spend	**Y-1 (prior year)** Incremental R&D Spend	**Y-2 (two years ago)** Incremental R&D Spend	**Y-3 (three years ago)** Incremental R&D Spend
$6,000,000	$5,000,000	$4,500,000	$4,000,000

Under the current R&D Tax Concession:-

- the 125% base R&D expenditure deduction in Y0 will be ($6,000,000 x 125%) = $7,500,000
- the Premium R&D Incremental deduction in Y0 will be = $750,000 #
- the total claim for taxation in Y0 will be ($7,500,000 + $750,000) = $8,250,000
- the total percentage claimed in Y0 will be ($8,250,000 / $6,000,000) x 100% = **137.5%***

Premium adjustment has been calculated using the ATO's Tax Schedule for the Research & Development tax concession 2006.

* Despite consistently increasing its eligible R&D expenditure over the time period, the company cannot access the full 175% R&D Premium. Consequently, the tax benefit of its total R&D claim is 137.5% which is considerably less than 175%.

Example 2:

Assume another situation for *ABC Ltd*. In this scenario, the company also spends $6,000,000 on current year R&D activities but only $4,502,000 is eligible tax R&D expenditure, with the balance spent on overseas activities *(for which an IRD Act section 39ED certificate was not obtained)* [19]and internal software development which will not be commercialized. The company's history of eligible R&D expenditure for taxation is now $4,502,000 *(Y0)* for current year and $5,000,000 *(Y-1)*, $4,500,000 *(Y-2)* and $4,000,000 *(Y-3)* for the previous three years ands is summarized as:-

Y0 (current year) Incremental R&D Spend	**Y-1 (prior year)** Incremental R&D Spend	**Y-2 (two years ago)** Incremental R&D Spend	**Y-3 (three years ago)** Incremental R&D Spend
$4,502,000	$5,000,000	$4,500,000	$4,000,000

Under the current R&D Tax Concession:-

- of the $6,000,000 spent on R&D during Y0, only $4,502,000 meets the criteria of being eligible R&D expenditure for taxation
- the 125% base R&D expenditure deduction in Y0 will be ($4,502,000 x 125%) = $5,627,500
- the Premium R&D Incremental deduction in Y0 will be = $1,000 #
- the total claim for taxation in Y0 will be ($5,627,500 + $1,000) = $5,628,500
- the total percentage claimed in Y0 will be ($5,628,500 / $4,502,000) x 100% = **125.02**% *
- If current year (Y0) eligible R&D expenditure had fallen to $4,500,000 or below, the Premium R&D incremental deduction would be Nil.

[19] Industry Research & Development Act 1986 as amended, Section 39ED

Premium adjustment has been calculated using the ATO's Tax Schedule for the Research & Development tax concession 2006.

* Despite consistently increasing its eligible R&D expenditure in the prior 3 years, the company cannot access the 175% R&D Premium in Y0 due to definitional issues affecting project eligibility. Consequently, the company is relying totally on the basic R&D concession of 125% in Y0 for assistance. It appears to be this sort of model that the Commission is proposing. i.e. to reward incremental R&D only, without regard to the impacts in terms of the total financial effects on claimants.

From the examples above, it can be seen that a decline of approximately 10% *(i.e. $500,000 in $ terms)* in eligible R&D tax concession expenditure *(refer example 2)* during the current year (Y0) would result in the claimant losing access to the R&D Premium. Therefore, assuming the Government policy was to change *(by acceptance of the Productivity Commission's recommendations)* causing a shift away from the basic 125% R&D taxation concession, the example 2 company would receive **no** assistance in Y0 – which may compromise its ability to continue conducting R&D in Australia. Using example 2 above, in order to re-instate the R&D Premium, expenditure in the following year (Y0+1) would need to increase to approximately $4,666,670 to allow minimal *(i.e. to a value of $1)* access to the R&D Premium.

Access to the full 175% Premium requires claimant company's to continue with year-on-year incremental increases *(in perpetuity)* in eligible R&D activities against a (3) three-year rolling average of eligible R&D expenditure in prior years. Year-on-year, the requirement for perpetual *(and significant)* increases in expenditure is simply not sustainable in the commercial world on the basis that claimants often reduce expenditure in one year versus another. Such expenditure reductions may arise due to changes in business economic conditions, definitional issues arising *(which affect eligibility of R&D activities for taxation)* when calculating R&D tax expenditure and changes in financial priorities which occur during normal business cycles. Hence, it is probable claimants for the R&D Premium would access a value that is lower than the additional 50% *(i.e. 175% - 125% = 50%)* available. **Therefore, it is our request that access to the full Premium deduction of 175% be made easier for longstanding and commercially successful applicants such as Integrated Research Limited**.

Accessing the base R&D concession rate of 125% is more predictable than accessing the 175% Premium. In its current format, the base R&D concession continues to provide an important financial and economic benefit to companies committed to undertaking R&D activities in Australia. Any proposal or consideration to remove the base tax concession has potential to adversely affect the economic viability of conducting R&D in Australia. The alternative focus by industry might be overseas and *(long-term)* this would also lead to a lowering of Australia's skills base in highly skilled labour intensive industries. **It is our request there be no further consideration to move away from the base 125% R&D tax deduction.**

Impact on Integrated Research

For IRI, the base R&D tax concession plays an important role in validating the company's decision to maintain its R&D activity base in Australia. As a software developer, the nature of IRI's R&D activities is labour intensive, requiring highly trained and expensive employee resources. Most of the company's development and product management personnel are educated to Bachelor degree level, with many having higher and advanced degrees in science, mathematics and engineering. At present, all of the company's R&D personnel are located in North Sydney NSW. This location not only provides benefits to the local Australian economy *(as employee wages are spent in Australia)* but also ensures this highly trained skills base remains in Australia with subsequent knowledge transfer through externalities to the local community as a consequence of the normal portability of former employees to positions outside the IRI group.

IRI operates in a fast paced and highly competitive global export market for its software products. By utilizing the R&D tax concession IRI remains competitive. The base R&D tax concession facilitates the employment of more labour resources and, in recent years, the after tax effect of the base R&D tax concession *(i.e. eligible R&D expenditure x 125% x 30%)* has enabled IRI to employ approximately four (4) additional development personnel during each financial year. This in turn has the spill-on effect of enabling development of the company's products to be completed expediently so our products become available in the commercial market at a rate which is quicker than would otherwise be attainable. For IRI's global business model, first to market is a critical issue as the company's PROGNOSIS software is mostly acquired by customers' as a part of a large and expensive infrastructure system project *(where software probably represents 5-15% of total project cost)* which typically has a five + year timeframe. Hence once a customer makes an initial purchase of PROGNOSIS *(or a competitive product)* it is unlikely they will then acquire an alternative product for many years as the change over costs to do so are significant. Instead, customers will tend to buy additional add-on products from the original software vendor.

IRI also accesses the R&D Premium *(but at a reduced percentage)* with the after tax affect allowing IRI to employ an additional one to two (1-2) development personnel during each financial year. Irrespective of the R&D Premium, without the base R&D tax concession, the company would need to seriously consider the relocation of its development activities and locate resources elsewhere.

We note the Draft Report proposal *"..... that the basic tax concession is likely to have a relatively low inducement rate because it provides an across-the-board subsidy to eligible expenditure regardless of whether the R&D would been undertaken anyway."* [20] Whilst this may be the perception from applying economic theory and from the marketing studies that have been conducted by AusIndustry, it is not the practical outcome from IRI's perspective. Should the proposal be adopted and the basic tax concession be removed to force companies to rely solely on the R&D Premium, it is probable that highly labour intensive R&D activities would need to shift to a region where either labour costs are lower or there is a higher level of taxation credits and/or expenditure concessions. In the absence of a base R&D concession in Australia, it would be difficult for IRI to maintain its market competitiveness and "first mover advantage" when commercializing its products in global markets without relocating R&D activity to another region. Relocation would occur on the basis that *(without the basic concession)* development labour costs in Australia would increase, thereby reducing the number of development staff employed within the constraints of budget funds available. Consequently, with fewer full-time labour resources, the development time-frame for products would lengthen, causing products to enter the market at a later date – thereby reducing the ability to obtain a competitive and commercial advantage on a timely basis.

To expect a company to rely solely on the R&D Premium is impractical in the real sense. As indicated in our *examples for ABC Ltd* above, a reduction of 10% in eligible R&D expenditure in the current year (Y-0) could adversely affect access to the Premium. Hence, without the basic tax concession there would be no incentive to conduct labour intensive R&D activities in Australia.

Examples

Assuming the base R&D concession is removed, changes in IRI's business circumstances and evolving R&D priorities may reduce the value of eligible R&D expenditure *(for taxation purposes)* in a particular year and therefore compromise the company's ability to access the R&D Premium – despite many years of increasing eligible expenditure. Accordingly, and as a means to illustrate the issue, there are at least three (3) possible situations with potential to impact negatively on IRI's eligible R&D *(taxation)* expenditure. These are:-

(a) Due to changes in economic and normal business cycles plus limited budget availability in a particular year, IRI may need to focus upon commercialization of previous R&D outcomes - rather than increasing the level of eligible R&D expenditure. Consequently, eligible R&D *(taxation*) expenditure in a financial year may be reduced *(for example by 10% to 15%)* to a level which precludes access to the R&D Premium. Under this

[20] Public Support for Science and Innovation: Productivity Commission Draft Research Report, November 2006, Chapter 9, Business programs, page 9.11 to 9.12

scenario, should the basic R&D concession be removed, then IRI would receive no taxation incentive for conducting its base level of R&D in Australia despite the activity being strategic to the company's business.

(b) During any particular year IRI may undertake an R&D *(core)* software project for an internal application to improve development processes etc. As the project involves core software development for internal use, sub-section 73B(2A)[21] will apply. Accordingly, despite significant expenditure being incurred, as the project's core activity is software *(i.e. not hardware)* based and the company does not have the intention to directly commercialize the R&D outcome to two (2) or more non-associates, project costs will be ineligible for the R&D taxation concession even though the project would lead to improved efficiency for internal processes and development activities. Consequently, eligible R&D expenditure will be reduced *(for example by 10% to 15%)* to a level which precludes the R&D Premium being accessed. Under this scenario, should the basic concession be removed, IRI would receive no taxation incentive for conducting this or any of its other R&D in Australia despite the activity being strategic to the company's on-going business.

(c) IRI operates in a fast paced global environment subject to constant technological change with the company's PROGNOSIS software providing performance monitoring software tools for business-critical computing and IP Telephony environments. In all circumstances, PROGNOSIS is dependant upon *(and operates in conjunction with)* products from other vendors including Hewlett Packard, Cisco, IBM, Sun, Microsoft, SUSE, Red-Hat, Avaya, eFunds, Oracle, BEA Systems plus others. Accordingly, as these vendors constantly change their products and operational environments there is a flow-on impact to PROGNOSIS requiring IRI to conduct expedient short time-cycle development to ensure the company's business model remains viable by PROGNOSIS continuing to operate in these changed environments.

Whilst IRI currently undertakes all R&D in Australia, the company also has high level technical employees based in the USA, UK and Germany. When combined with its Australian resources, these overseas employees provide IRI with the option to conduct R&D on a 24 x 7 "follow the sun" timeframe – thereby reducing development time-frames. Accordingly, circumstances may prevail where short-cycle R&D is required to meet commercial expectations and the only resources available are those located in the company's overseas offices and further, it is not convenient for the company to lodge an application with AusIndustry under section 39EC[22] prior to commencing the R&D to obtain a section 39ED[23] certificate approving a level of overseas R&D activity. Accordingly, despite significant expenditure being incurred and the company having the intention to commercialize the R&D outcome to two (2) or more non-associates, project costs will be ineligible for the R&D taxation concession due to the overseas content. Consequently, eligible R&D expenditure will be reduced *(for example by 10% to 15%)* to a level which precludes the R&D Premium being accessed. Under this scenario, should the basic concession be removed, then IRI would again receive no taxation incentive for conducting this R&D in Australia despite the activity being strategic to the company's business.

Removal of the Base R&D Concession

Assuming the Draft Report's recommendation to move away from the base 125% tax concession is adopted, there are several practical matters which require the Productivity Commission's further consideration.

Firstly, specific R&D expenditure items (*currently covered by the R&D tax concession)* receive taxation treatment that is unique to their nature as R&D expenditure. *For example*, core technology acquisitions, plant expenditure, feedstock expenditure, prototype expenditure, interest expense, overseas expenditure etc.

[21] Income Tax Assessment Act – Section 73B(2A)
[22] Industry Research & Development Act 1986 as amended, Section 39EC
[23] Industry Research & Development Act 1986 as amended, Section 39ED

- Therefore, will such items still be regarded as R&D expenditure *(albeit, without the 125% multiplier applied)* or will further amending legislation or regulations be necessary to remove all concessions available?
- Further, how onerous will the outcome of possible amending legislation become for companies to implement?

Secondly, as specific R&D expenditure items are required as a base for calculating eligible expenditure for the R&D Premium, we envisage an even more complex system of expense record retention and classification will be required to accommodate a need for two (2) sets of expenditure calculations – (a) initially to determine if the applicant company meets the criteria for the R&D Premium and then, (b) *(assuming the base concession is removed)* if the company is not eligible for the R&D Premium in a particular year the expenses will most likely be treated in a completely different manner. Accordingly, with two disparate expense treatment methodologies in existence, we envisage the system would be more difficult and expensive for companies to manage than currently. If it is the intention to further discourage corporate entities in Australia from claiming the R&D tax concession, this will certainly work well!

Thirdly, applying the proposal to remove the base tax concession, it seems appropriate to assume that most development costs would revert to more traditional *(i.e. non-concessional)* treatment for taxation purposes. Accordingly, given the current strength of the Australian Dollar against the US Dollar and Asian currencies *(i.e. non-European currencies)*, the economics of continuing to conduct labour intensive R&D activities in Australia will diminish.

Example - Comparative R&D Costs and After Tax Returns on Income

To illustrate the importance of the base 125% tax concession for Australian companies, we have undertaken a very simple theoretical exercise to show a comparison of the After Tax Returns of conducting R&D as a cost centre in Australia and in several other countries. The example company is one which commercializes software products on a global basis whilst operating its business from Australia and conducts comparable labour intensive software development *(for each example)* in various global regions – being Australia, India, United Kingdom, United States of America, Germany, Ireland, New Zealand and Singapore.

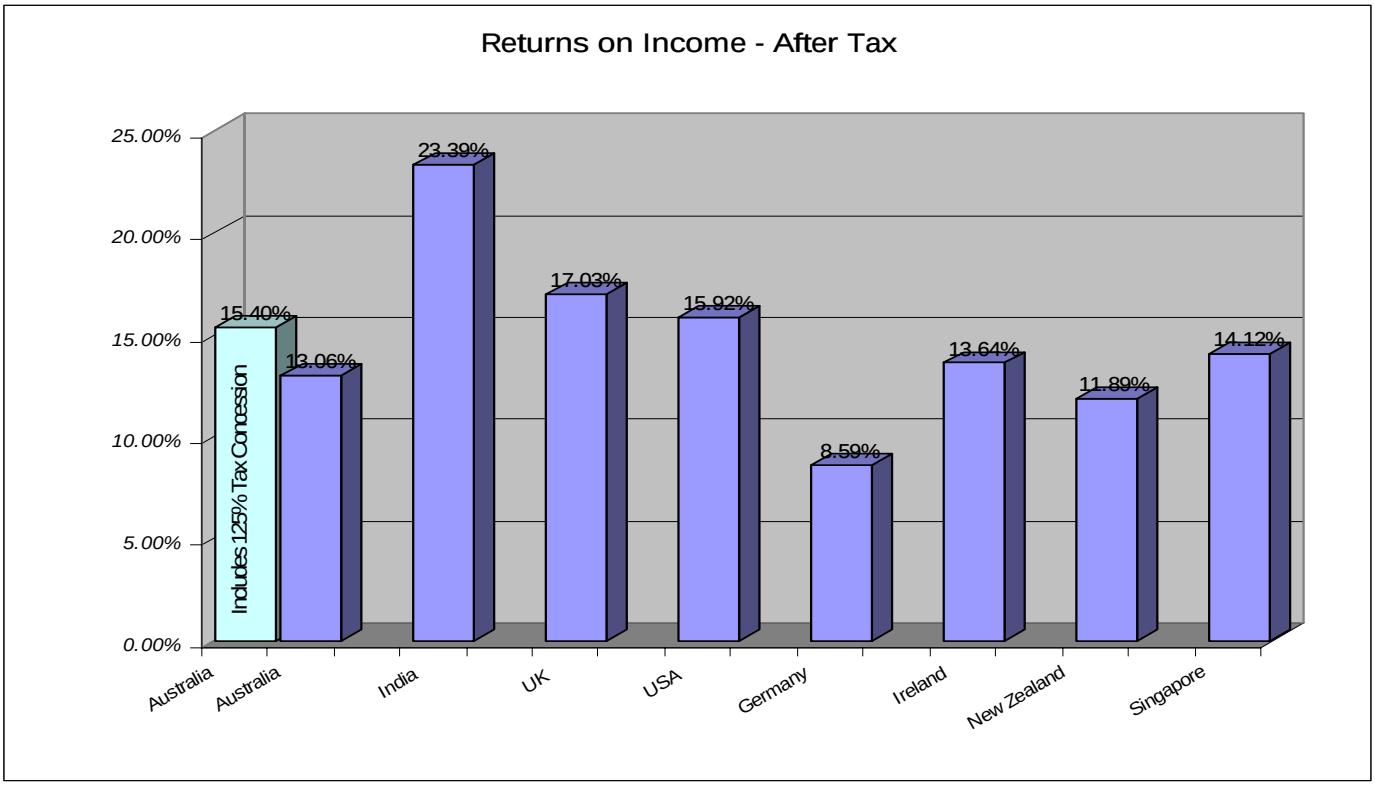
In the example we have assumed the following basic criteria:-

- The company is an Australian incorporated and domiciled company.
- All license revenue is earned overseas but reported in Australia. License revenue is recognized when it is invoiced – i.e. there is no deferred revenue adjustment.
- Other Revenue is for consulting, interest earned etc.
- All non-R&D operating costs are incurred in Australia and remain constant.
- For accounting purposes, AIFRS is applied to the treatment of R&D expenditure which is allocated as 45% Research and 55% Development. As a result, Development costs are capitalized and amortized over the product economic life.
- Amortization is charged over a 4 year period of economic life for the product.
- To simplify amortization calculations, R&D costs in the prior two (2) years are the same in constant currency and amortization treatment.
- Foreign currency rates are constant year on year. Any changes could act to accelerate the benefits of moving offshore.
- All R&D *(whether conducted in Australia or an overseas location)* is conducted at an R&D cost centre, with all costs being brought back to Australia to be expensed in the company's P&L for reporting purposes.
- In each comparison there are 6 teams of 8 software engineers undertaking the R&D in the relevant country.
- R&D salaries are calculated using local region "total average compensation data" and represent total compensation.
- All income tax is paid in Australia at a 30% tax rate.

- There are 100 million shares issued for the company.

Whilst not attempting to provide a sophisticated financial/economic analysis, the model does provide a direct comparison of possible impacts on After Tax Returns when R&D activities are conducted in regions where alternative labour costs prevail. In particular, there is a positive impact on returns due to cheaper labour costs in India, whilst the current relatively weak US Dollar against the Australian Dollar makes the cost of labour in the United States more competitive against labour costs in Australia. The model does not consider: - practical issues likely to impact on business management; the difficulty of maintaining the integrity of intellectual property when R&D is conducted offshore *(not a major issue in some countries)*; or, the impact of tax incentives offered by overseas governments as an incentive to conduct R&D in their country. It should be noted that many other countries offer R&D tax concessions and we are not aware of any country following the lead proposed by the Commission in its draft recommendations.

With reference to the diagram below, and with all else being equal, the theoretical After Tax Return to companies that conduct R&D in Australia are increased as a result of the 125% base tax concession. For the example given, applying the base R&D concession to eligible R&D expenditure conducted in Australia results in an After Tax Return of 15.40% *(and ranked No: 4 of 8 counties considered)*. Upon removal of the base tax concession *(assuming there are no other changes to the legislation)*, the After Tax Return of conducting R&D in Australia reduces to 13.06% and Australia's ranking in this example declines to No: 6 of 8 countries considered. Clearly, the economics of conducting R&D in Australia are enhanced by assistance provided by the base R&D concession.



*Pro-forma Income statements and comparative wage information used to calculate the returns for the above example are contained in **Appendix 2**, to this document.*

Accordingly, removal of the base tax concession will increase the likelihood of R&D activities for labour intensive industries being moved offshore rather than continuing to be conducted in Australia. For the example provided, this would mean the loss of 54 highly skilled software engineers and supervisors from Australia's skill base to the benefit of increasing another country's skills base. As a result, the wages earned by such people would be spent outside of Australia to the benefit of another economy. Not withstanding the loss of wages being spent in Australia, there would also be a loss to the Australian taxation base from employee PAYG deductions foregone – for the *example with ABC Ltd* given, an estimate of PAYG deductions would be approximately $2.5 million per annum.

R&D Spillovers

In relation to the impact that spillovers provide as a rationale for public support of R&D, the Draft Report considers:- *"…..The strongest case for public support based on spillovers occurs …..…..where businesses are engaged in novel R&D activities that either spill over cheaply to others or trigger cycles of innovation by rivals. The spillover benefits will be greatest when there are many potential domestic beneficiaries from spillovers (generic technologies, or many potential users of the spillover technology because of industry structures)."*[24]

Assuming the proposal to move away from the base R&D concession is adopted and implemented, not only will R&D activities move overseas, there will most likely be a reduction in the pool of Australia's skills base going forward. Accordingly, it is likely fewer school leavers will seek to commence higher education in technical vocations. Consequently Australia's national skills-base will diminish as fewer highly trained engineers and technicians will be available in future years with commercially focused experience who are able to provide externalities such as spillovers either from the results of their R&D work as suggested, or of their skills to other Australians. Similarly, if Australia's future is one without sustainable high technology industries, there will be little incentive for those highly skilled Australians currently working overseas to return home during their productive years to seek employment within local organisations - where they could share and impart the knowledge and skills gained whilst working overseas to others in Australia. Hence the Productivity Commission's proposal appears to be short-sighted.

Research Programs in Other Regions

Should the Productivity Commission's proposal to remove the base tax concession be adopted, Australia will be in a situation that is quite disparate with many OECD trading partners. In a 2005 statement to the U.S. Senate Committee on Finance, David Hernandez (Vice President, Taxes and General Counsel at EDS, Plano, Texas, USA) indicated that *"…between 2002 and 2004, Belgium, Ireland and Norway established new R&D tax incentive regimes, bringing to 18 the number of OECD countries employing tax incentives for R&D"*.[25] Clearly, amongst OECD countries *(including Australia)*, a tax credit system to assist with investment in R&D is acknowledged as a stimulus for innovation.

In his submission, Mr. Hernandez indicated that many small U.S. based companies have used the U.S. R&D tax credit as a way to reduce the costs of investing in research, with the tax credit meaning the difference between a project getting the green light or being put back on the shelf.[26] From experience, this situation also exists in Australia as *(unlike the R&D Premium)* the base R&D tax incentive is predictable and therefore enables companies to make investment decisions on commencing R&D projects *(in advance)*. This allows companies to hire additional technical employees with certainty at a project's commencement. This investment has a flow-on effect to organizations whose

[24] Public Support for Science and Innovation: Productivity Commission Draft Research Report, November 2006, Chapter 3, Rationales for public support, page 3.18

[25] Hernandez, David, Vice President, Taxes and General Counsel, EDS, Plano Texas. On behalf of The R&D Tax Credit Coalition Before the Senate Committee on Finance March 16, 2005. Paper contained in documents obtained from the R&D Credit Coalition, Washington DC, USA

[26] Hernandez, David, Vice President, Taxes and General Counsel, EDS, Plano Texas. On behalf of The R&D Tax Credit Coalition Before the Senate Committee on Finance March 16, 2005. Paper contained in documents obtained from the R&D Credit Coalition, Washington DC, USA

livelihoods are linked to the products and services developed as a result of the additional research – i.e. provision of supporting services to the R&D company in the manufacturing, services, retail & wholesale trade, construction, real estate sectors in the local economy[27], etc, which ultimately leads to the supporting organizations hiring more people.

A summary of R&D incentives offered by some countries is included in Appendix 3. The summary, prepared by the U.S. R&D Credit Coalition,[28] shows that many of Australia's regional competitors offer tax credit incentives which compare directly to Australia's current system. Of interest is that China offers foreign investment enterprises a deduction for R&D expenditure, whilst India, Japan, Korea and Singapore offer various levels of support.

Conclusion

Government support of commercially focussed innovation via the core (125%) R&D tax concession is a vital component towards stimulation of corporate innovation within the Australian economy. To contemplate removal *(or a further reduction in the overall tax effectiveness thereof)* of the core R&D incentive would be detrimental to the future sustainability of corporations conducting labour intensive and commercially focussed R&D in Australia. Accordingly, it is likely corporations currently undertaking R&D within Australia will need to consider moving those activities to other countries where innovation is fostered by the provision of tax incentives/tax credits.

The fact that the Australian model of R&D tax concessions is so widely accepted and admired overseas, suggests that it is the best model presently available. This is further supported by the fact that revenue authorities from around the world visit and model their tax concessions on Australia's tax concession. Australia was one of the first countries to introduce an R&D tax concession model and did so in the face of seriously declining levels of R&D activity in Australia. Consequently, the basic tax concession has helped to stem the tide of industry innovation and, over its life, the tax concession has provided stimulus for companies to continue undertaking R&D investment at a local level.

There is an old adage which maintains relevance to this matter, i.e. *if it is not broken don't fix it.* This does not mean we can not improve what we have, as noted above we have many problems already with administration of the present tax concession. We understand the Inspector General of Taxation is about to commence a review regarding the administration of the R&D tax concession by the ATO and the ANAO has reported on the work of AusIndustry.

In preparing its Draft Report, the perceptions the Productivity Commission has gained with respect to the 125% base level concession are in our view based on flawed questioning and analysis. It is our view that the 125% concession is critical for maintaining the level of business R&D in Australia. In simple terms, altering the structure and system of benefits available to companies, in such a labour agile market for skilled personnel will result in certain areas of R&D activity being largely migrated from Australia's shores.

[27] Hernandez, David, Vice President, Taxes and General Counsel, EDS, Plano Texas. On behalf of The R&D Tax Credit Coalition Before the Senate Committee on Finance March 16, 2005. Paper contained in documents obtained from the R&D Credit Coalition, Washington DC, USA

[28] International R&D Tax Incentives, 2005. R&D Credit Coalition, 1331 Pennsylvania Ave, NW, Ste 600, Washington DC 20004 – www.investinamericasfuture.org

Appendix 1

TABLE 1: REDUCTION in EFFECTIVENESS of the R&D TAX CONCESSION

Period	Company Tax Rate (a)	R&D Tax Concession Rate (b)	Tax Rate x Concession Rate (a) x (b) = (c)	Additional Benefit by reduction in Company Tax Payable (c) - (a)
1 July 1985 to 30 June 1987	46%	150%	46% x 150% = 69.0%	69.0% - 46% = 23.0%
1 July 1987 to 30 June 1989	49%	150%	49% x 150% = 73.5%	73.5% - 49% = 24.5%
1 July 1989 to 30 June 1993	39%	150%	39% x 150% = 58.5%	58.5% - 39% = 19.5%
1 July 1993 to 30 June 1995	33%	150%	33% x 150% = 49.5%	49.5% - 33% = 16.5%
1 July 1995 to 20 August 1996	36%	150%	36% x 150% = 54%	54.0% - 36% = 18.0%
21 August 1996 to 30 June 2000	36%	125%	36% x 125% = 45.0%	45.0% - 36% = 9.0%
1 July 2000 to 30 June 2001	34%	125%	34% x 125% = 42.5%	42.5% - 34% = 8.5%
1 July 2001 to current	30%	125%	30% x 125% = 37.5%	37.5% - 30% = 7.5%

Since inception of the R&D Tax Concession, amendments to the company tax rate and the R&D Tax Concession rate have diminished the effectiveness of the base concession by 206%. When the 49% corporate tax rate that was applicable in 1986/87 is considered, the reduction in the R&D Tax Concession's effectiveness of the base concession is 226%.

R&D Tax Concession Premium				
1 July 2001 to current	30%	175%	30% x 175% = 52.5%	52.5% - 30% = 22.5%

Appendix 2a

Country => *Region =>*	Australia *Sydney*	India *all cities*	United Kingdom *Reading*	USA *Colorado central*	Germany *Frankfurt*	Ireland *All cities*	New Zealand *all cities*	Singapore
Software Engineer								
Currency	*AUD*	*Indian Rupees*	*Pds Sterling*	*USD*	*Euros*	*Euros*	*NZ Dollars*	*Singapore Dollars*
average annual salary	119,119	1,320,010	34,382	68,603	91,941	68,193	143,872	134,221
average total compensation	123,228	1,360,206	36,175	78,156	95,138	71,171	149,675	137,772
AUD - FX rate	*1.00*	*32.76*	*0.40*	*0.78*	*0.60*	*0.60*	*1.13*	*1.20*
average annual salary	119,119	40,293	85,955	87,953	153,235	113,655	127,320	111,851
average total compensation	123,228	41,520	90,438	100,200	158,563	118,618	132,456	114,810
Software Design Supervisor								
Currency	*AUD*	*Indian Rupees*	*Pds Sterling*	*USD*	*Euros*	*Euros*	*NZ Dollars*	*Singapore Dollars*
average annual salary	140,476	1,555,934	45,172	83,644	108,416	80,418	169,627	158,270
average total compensation	157,868	1,742,774	51,362	102,682	121,844	91,024	191,598	176,620
AUD - FX rate	*1.00*	*32.76*	*0.40*	*0.78*	*0.60*	*0.60*	*1.13*	*1.20*
average annual salary	140,476	47,495	112,930	107,236	180,693	134,030	150,112	131,892
average total compensation	157,868	53,198	128,405	131,644	203,073	151,707	169,556	147,183

Source data:

- Salary details obtained from salaryexpert.com and is derived from non-copyrighted government salary surveys from each country's National Labor/Statistics Office. 2007 © Copyright Baker, Thomsen Associates Insurance Services, Inc
- Exchange rates are approximate rates for close of trading on 9 January 2007.

Appendix 2b

	R&D in Australia		R&D Cost Centre	R&D Cost Centre	R&D Cost Centre	R&D Cost Centre	R&D Cost Centre	R&D Cost Centre	R&D Cost Centre
	Australia	Australia	India	UK	USA	Germany	Ireland	New Zealand	Singapore
	Sydney	*Sydney*	*All cities*	*Reading*	*Colorado*	*Frankfurt*	*All cities*	*All cities*	*Singapore*
	125% Tax	No 125% Tax	No 125% Tax	No 125% Tax	No 125% Tax	No 125% Tax	No 125% Tax	No 125% Tax	No 125% Tax
License Revenue	20,000,000	20,000,000	20,000,000	20,000,000	20,000,000	20,000,000	20,000,000	20,000,000	20,000,000
Other revenue	2,000,000	2,000,000	2,000,000	2,000,000	2,000,000	2,000,000	2,000,000	2,000,000	2,000,000
Total Revenue	**22,000,000**	**22,000,000**	**22,000,000**	**22,000,000**	**22,000,000**	**22,000,000**	**22,000,000**	**22,000,000**	**22,000,000**
SGA costs	13,000,000	13,000,000	13,000,000	13,000,000	13,000,000	13,000,000	13,000,000	13,000,000	13,000,000
R&D Costs	6,862,152	6,862,152	2,312,148	5,111,454	5,599,464	8,829,462	6,603,906	7,375,224	6,393,978
Capitalised R&D	-3,774,184	-3,774,184	-1,271,681	-2,811,300	-3,079,705	-4,856,204	-3,632,148	-4,056,373	-3,516,688
Amortisation of R&D	2,398,179	2,398,179	808,048	1,786,347	1,956,896	3,085,713	2,307,928	2,577,487	2,234,562
Total Operating Costs	**18,486,148**	**18,486,148**	**14,848,514**	**17,086,501**	**17,476,655**	**20,058,971**	**18,279,685**	**18,896,338**	**18,111,852**
Accounting Profit Before Tax	**3,513,852**	**3,513,852**	**7,151,486**	**4,913,499**	**4,523,345**	**1,941,029**	**3,720,315**	**3,103,662**	**3,888,148**
Income Tax	126,693	641,354	2,006,356	1,166,564	1,020,161	51,161	718,828	487,433	781,807
Accounting Profit After Tax	**3,387,159**	**2,872,498**	**5,145,130**	**3,746,935**	**3,503,184**	**1,889,868**	**3,001,487**	**2,616,229**	**3,106,341**
Basic EPS (100 mil issued)	$ 0.0339	$ 0.0287	$ 0.0515	$ 0.0375	$ 0.0350	$ 0.0189	$ 0.0300	$ 0.0262	$ 0.0311
After Tax RO Income	15.40%	13.06%	23.39%	17.03%	15.92%	8.59%	13.64%	11.89%	14.12%
Profit for Tax (refer note 1 below)	2,137,848	2,137,848	6,687,852	3,888,546	3,400,536	170,538	2,396,094	1,624,776	2,606,022
R&D adjustment	1,715,538	0	0	0	0	0	0	0	0
Profit for Tax after R&D adjustments	422,310	2,137,848	6,687,852	3,888,546	3,400,536	170,538	2,396,094	1,624,776	2,606,022
Income Tax @30%	126,693	641,354	2,006,356	1,166,564	1,020,161	51,161	718,828	487,433	781,807

Note 1: Profit for tax after adjusting for R&D capitalisation and R&D amortisation which are not taken up for taxation.

Appendix 3

The following table, *including all of the Comments shown in the right hand column*, has been prepared by the United States of America based organization called "R&D Credit Coalition". This organization represents more than 1,000 small, medium and large U.S. companies and 85 professional and trade associations. All dollar values are quoted in US Dollars and all of the comments are U.S. centric in their viewpoint. The table provides an indication of the importance that is place upon the provision of R&D tax credits from the perspective of another country, being the United States during early 2006 – i.e. a country that is not Australia.

Country	**R&D Tax Incentive**	**Comment** *(views of R&D Credit Coalition)*
Australia	• Allows a 125% deduction for R&D expenses • Plus a 175% deduction for R&D expenditures exceeding a base amount of prior-year spending	The 125% deduction is equivalent of a flat 7.5% R&D tax credit. In discussing its R&D-friendly environment, the Australian government's website (investaustralia.com) concludes, *"Its little surprise then, that many companies from around the world are choosing to locate their R&D facilities in Australia"*. The government also points out that *"50% of the most innovative companies in Australia are foreign-based"*.
Canada	• Offers a permanent 20% flat (i.e., first-dollar) R&D tax credit. • *Also*, many provincial governments offer various incentives (e.g. refundable credits) for R&D activities conducted in their provinces.	In 2003, US subsidiaries spent $2.5 billion on R&D in Canada, which has mounted an aggressive marketing campaign, including television and print advertisements, to lure more U.S. companies to locate R&D operations north of the border. Ontario print advertisement discusses "R&D tax credits, among the most generous in the industrialized world" and "a cost structure which KPMG confirms as lower than the U.S. and Europe"; the advertisement concludes, "you'll see why R&D in Ontario is clearly worth investigating".
China	• Offers foreign investment enterprises a 150% deduction for R&D expenditures, provided that R&D spending has increased by 10% from the prior year.	The 10% incremental-increase threshold should not be difficult to meet for U.S.-owned companies growing start-up operations in China. China's Ningbo Economic & Technical Development Zone ("NETD") invites global companies to "enjoy a number of preferential taxation policies," as well as other benefits.
France	• Allows a 50% R&D credit, includes a 10% flat credit and a 40% credit for R&D expenditures in excess of average R&D spending over the two previous years.	France recently expanded the scope of eligible R&D expenses that serve as a basis for the computation of the credit. Beginning in 2006, taxpayers can take into account twice the actual amount of salaries paid during 12 months for the first employment of certain newly-graduated searchers; and can claim up to Euro 10M (up from Euro 8M) in research sub-contracting payments made to certain qualifying entities. In 2003, U.S. subsidiaries spent $1.8 billion on R&D in France. "This is the first time in our industry that Americans are coming to Europe to join the R&D of Europeans," Pasquale Pastore, President and CEO of STMicroelectronics, in *The New France. Where the Smart Money Goes.*
India	• Companies carrying on scientific research and development are entitled to a 100% deduction of profits for 10 years. • Automobile industry also is entitled to	"More than 100 global companies … have established R&D centers in India in the past 5 years, and more are coming. …. As I see it from my perch in India's science and technology leadership, if India plays its cards right, it can become by 2020 the world's number-one knowledge production center," Raghunath Mashelkar, Director

	a 150% deduction for expenditures on in-house R&D facilities.	General, Council for Scientific & Industrial Research, India, in *Science Magazine.*
Ireland	• Offers a 20% R&D tax credit, plus a full deduction, as well as a low generally applicable 12.5% corporate income tax rate. • Capital expenditures may also qualify for a separate flat credit.	According to IDA Ireland, the government agency with responsibility for the promotion of direct investment by foreign companies into Ireland, "Many leading global companies have found Ireland to be an excellent location for knowledge-based activities … Nearly half of all IDA supported companies now have some expenditure on R&D and 7,300 people are engaged in this activity."
Japan	• Offers a flat 10% R&D tax credit (a 15% flat credit is provided for small companies), in addition to other incentives.	In 2003, U.S. subsidiaries spent $1.7 billion on R&D in Japan. Junichiro Mimaki, an official from Japan's Ministry of Economy, Trade, and Industry, said in an August 26 interview with the Bureau of National Affairs that R&D and IT tax relief has created 400,000 jobs and boosted gross domestic product by 6.1 trillion yen ($55 billion) over three years.
Korea	• Tax holidays, up to 7 years, are provided for high-technology businesses. • In addition, a variety of tax credits are provided for R&D-type expenditures.	Korea is moving aggressively to attract foreign R&D investment, promoting not only tax incentives but also other benefits for foreign companies locating R&D in the Incheon Free Economic Zone ("IFEZ").
Singapore	• "R&D and Intellectual Property Management Hub Scheme" offers U.S. companies a 5-year tax holiday for foreign income earned with respect to Singapore-based R&D.	According to Singapore's Economic Development Board website, "Singapore does not just welcome business ideas; it actively seeks and nurtures them. We play host to any shape and size of enterprise and innovation – startups with little more than the germ of an idea; global corporations with large R&D teams and complex production operations."
United Kingdom	• Allows a 125% deduction for R&D expenses, plus a 175% deduction for R&D expenditures exceeding a base amount of prior-year R&D spending.	The UK leads the world in attracting R&D investment by U.S. affiliates – U.S. subsidiaries spent more than $4 billion on UK-based R&D in 2003. The 125% deduction alone is the equivalent of a flat 7.5% R&D tax credit.
United States	• Allows a maximum 10% incremental credit (a nominal 20% credit) for qualified R&D expenditures in excess of a calculated base amount. • An Alternative Incremental Research Credit formula is also available. The AIRC computation combines a three-tiered fixed-base percentage with a reduced three-tiered credit percentage. • The business deduction for R&D expenses must be reduced by the amount of any R&D credit.	The U.S. R&D credit expired on December 31, 2005. Congress currently is considering legislation (H.R. 4297) that would reinstate a strengthened R&D credit for up to 2 years. The strengthened credit includes a new Alternative Simplified Credit ("ASC") intended to provide an incentive for U.S.-based R&D to more R&D-intensive companies. Under the ASC calculation, a company would be eligible for a credit of 12% of R&D expenditures that exceed 50% of average R&D expenditures over the prior three years.

Source of Table:
R&D Credit Coalition, 1331 Pennsylvania Avenue, NW Ste 600, Washington DC 20004 USA, www.investinamericasfuture.org