Law Council
OF AUSTRALIA

Business Law Section

Better targeting the Research and Development Tax Incentive

Treasury

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Introduction

1. The Taxation Committee of the Business Law Section of the Law Council of Australia **(Committee)** makes this submission to Treasury in response to the exposure draft, *Treasury Laws Amendment (Tax Reform No. 5) Bill 2026: Better targeting the Research and Development Tax Incentive*, and the accompanying explanatory materials.

2. This submission addresses the proposed amendments to the research and development tax incentive (**RDTI**) contained in Schedule # to the exposure draft legislation (the schedule number has not yet been allocated in the exposure draft). The amendments would amend the *Industry Research and Development Act 1986* (**IRD Act**) and the *Income Tax Assessment Act 1997* (**ITAA 1997**).

3. This submission should be read together with the Law Council of Australia's submission to Treasury of 17 July 2026, prepared with the contribution of the Taxation Committee of the Business Law Section and the Law Institute of Victoria, in relation to the proposed Innovative Business CGT Concession (**IBCC**) (**Earlier Submission**). This submission should also be read with the Law Council's submission of 9 June 2026 to the Senate Standing Committees on Economics in relation to the *Treasury Laws Amendment (Tax Reform No. 1) Bill 2026* and related measures.

4. The Earlier Submission and the Senate submission raised broader concerns about the design and implementation of the proposed capital gains tax reforms. Several of those concerns remain directly relevant to the RDTI reforms because the two regimes interact. Companies that claim the RDTI refundable offset are frequently the same companies whose founders, employees and investors are affected by the capital gains tax changes.

5. The Committee supports the policy objective of ensuring that Australia's tax system encourages private-sector research and development expenditure. The RDTI is a significant component of Australia's innovation infrastructure, and its reform should be approached with care.

6. However, the package of reforms, taken as a whole, contains elements that risk undermining the stated objective. Several measures intended to improve targeting will, in practice, reduce the availability and certainty of the incentive for genuine research and development activity, particularly in the technology sector. The Committee's guiding principles include delivering certainty, predictability and fairness to those whose activities are governed by business law. The restrictive elements of this package are in tension with those principles.

Background

The reforms to the RDTI announced in the 2026-27 Budget

7. The Government announced the proposed reforms to the RDTI in the 2026-27 Federal Budget, drawing on recommendations in the Ambitious Australia - *Strategic Examination of Research and Development final report*, published by the Department of Industry, Science and Resources (**DISR**) in March 2026 (**Ambitious Australia Report**). The stated objective is to better target the incentive towards genuine research and development activity and to ensure that public expenditure on the programme delivers measurable benefits to the Australian economy.

8. The exposure draft legislation proposes the following principal changes:

   (a) an increase in the minimum annual R&D expenditure threshold from $20,000 to $50,000. The test concerns the total of specified notional deductions, subject to the exceptions in subsection 355-100(2). The amendments change the heading to subsection 355-100(2), amend subsection 355-100(2) and amend the table heading in that subsection [Schedule #, items 11 to 13, subsection 355-100(2) of the ITAA 1997];

   (b) where the total notional deductions are below $50,000, only qualifying expenditure incurred to a registered research service provider that is not an associate, and deductible Cooperative Research Centre contributions, remain eligible for the offset under subsection 355-100(2) [Schedule #, subsection 355-100(2) of the ITAA 1997];

   (c) removal of supporting R&D activities as a separate category, with 'core R&D activities' renamed to 'R&D activities' [Schedule #, items 32 to 41 and 43 to 48 of the ITAA 1997; items 49 to 73 of the *IRD Act*]. The new subsection 355-25(2A) expressly provides that an activity is not an R&D activity merely because it is directly related to, or is undertaken for the purpose of supporting, another activity that is an R&D activity [Schedule #, item 42, subsection 355-25(2A) of the ITAA 1997];

   (d) a new 10-year limitation on access to the refundable tax offset. Table item 1A in subsection 355-100(1) applies where the R&D entity's aggregated turnover is less than $50 million and any day during the income year occurs on or after the tenth anniversary of the start day. In that case, the entity receives its corporate tax rate plus 23 percentage points on a non-refundable basis for the whole income year, including where the anniversary falls part-way through that year. The refundable offset in table item 1 is available only where table items 1A and 2 do not apply. The 'start day' is the earlier of the day the R&D entity, or another entity mentioned in subsection 355-100(6), first started carrying on an enterprise, or the day the R&D entity, or another entity mentioned in subsection 355-100(6), was first registered for R&D activities under Part III of the Industry Research and Development Act 1986 [Schedule #, items 4 to 6, table items 1 and 1A in subsection 355-100(1) and subsection 355-100(6) of the ITAA 1997];

(e) a 15-year period for entities conducting R&D activities relating to therapeutic goods [Schedule #, item 17, subsections 355-100(4) and (5) of the ITAA 1997; item 26, section 28EA of the IRD Act];

(f) an increase in the refundable turnover threshold from $20 million to $50 million [Schedule #, items 1 and 3, section 355-1 and table item 1 in subsection 355-100(1) of the ITAA 1997];

(g) an increase in the annual expenditure cap from $150 million to $200 million [Schedule #, items 2 and 14 to 16, subsection 355-100(3) of the ITAA 1997];

(h) an increase in both the refundable and non-refundable offset rates by 4.5 percentage points [Schedule #, items 5, 6, 8 and 10, table items 1 and 1A in subsection 355-100(1), and table items 1 and 2 in subsection 355-100(1A) of the ITAA 1997]; and

(i) a reduction in the intensity threshold from 2 per cent to 1.5 per cent [Schedule #, items 7 and 9, table items 1 and 2 in subsection 355-100(1A) of the ITAA 1997]; and

(j) entities that are past the tenth anniversary, or the fifteenth anniversary for therapeutic goods R&D, and have aggregated turnover below $50 million remain entitled to the highest offset rate, 23 percentage points above their corporate tax rate, but on a non-refundable basis [Schedule #, items 5 and 6, table items 1 and 1A in subsection 355-100(1) of the ITAA 1997].

9. Schedule # commences on the first 1 January, 1 April, 1 July, or 1 October to occur after Royal Assent. The amendments in Part 1 apply to assessments for income years commencing on or after 1 July 2028 (item 31). The amendments in Part 2 apply to assessments for income years commencing on or after that date (subitem 74(1)) [Schedule #, commencement table and items 31 and 74].

10. The Committee recognises that several of these measures represent welcome improvements to the existing RDTI framework. In particular, the increases to the offset rates, the expenditure cap and the refundable turnover threshold are constructive and have the potential to improve the practical value of the incentive for genuine R&D claimants.

11. However, the Committee is concerned about the restrictive elements of the package. These include the 10-year limitation on refundable offsets, the removal of supporting activities, the breadth of the connected entity and affiliate tracing rules, and the increase in the minimum expenditure threshold. These measures will reduce the accessibility and certainty of the RDTI for businesses that undertake genuine and often substantial research and development.

Executive Summary

The Committee supports the objective of encouraging R&D in Australia

12. The Committee supports the policy objective of ensuring that Australia's tax system encourages genuine private-sector expenditure on research and development. An effective RDTI is important to Australia's capacity to attract and retain research talent, develop commercially significant intellectual property and compete for globally mobile research investment.

The positive elements of the package are acknowledged

13. The Committee acknowledges that the exposure draft contains a number of constructive measures. The increase in offset rates by 4.5 percentage points, the raising of the refundable turnover threshold from $20 million to $50 million, the increase in the expenditure cap from $150 million to $200 million, and the reduction in the intensity threshold from 2 per cent to 1.5 per cent are welcome. The base refundable rate becomes 23 percentage points above the corporate tax rate. For entities subject to the intensity premium, the first tranche of notional deductions (up to 1.5 per cent of total expenses) attracts an additional 13 percentage points and only the excess tranche attracts an additional 21 percentage points. An entity within proposed table item 1A instead receives a non-refundable offset at its corporate tax rate plus 23 percentage points.

The package contains restrictive elements that require reform

14. However, the package also contains restrictive elements that, without amendment, will undermine the stated policy objectives. The Committee's principal concerns are as follows.

***Software eligibility*.**

15. Software development is the principal form of R&D activity for a large and growing segment of the Australian economy, including financial technology, health technology, cybersecurity, regulatory technology, and platform businesses. The exposure draft does not expressly affirm that software development qualifies as an R&D activity when the statutory experimental criteria are satisfied. Existing guidance addresses software but would need revision to explain the proposed removal of supporting activities and its effect on software claims. The Committee recommends affirming eligibility and providing contemporary worked examples. It also recommends revised published guidance and, where appropriate, an ATO public ruling on taxation issues within the Commissioner's remit.

Connected entities and affiliates.

16. The proposed tracing of the 10-year refundable offset limitation through affiliates and connected entities is overbroad. It may, in its current form, apply the commencement date of one entity to an unrelated entity where the statutory connected-entity or affiliate tests are met, including in some common-control or investment arrangements, without continuity of the subsidised research project. The Committee

recommends replacing the broad tracing rules with a purpose-based anti-rebirthing test and expressly excluding relationships that do not indicate that continuity.

Removal of supporting activities.

17. The removal of supporting R&D activities as a separate category, combined with proposed subsection 355-25(2A) [Schedule #, item 42, subsection 355-25(2A) of the ITAA 1997], creates ambiguity about the scope of eligible R&D activities. The explanatory materials make clear that removing eligibility for supporting activities is intended to narrow the eligible base. The legislation and guidance should identify how to distinguish activities meeting the experimental test in their own right from activities that merely support them. The Committee recommends expressly preserving work directly necessary to formulate, conduct, observe and evaluate experiments.

The $50,000 minimum threshold.

18. The increase in the minimum annual expenditure threshold from $20,000 to $50,000 may exclude very early-stage innovators and bootstrapped ventures whose qualifying notional deductions fall below $50,000 and who cannot rely on the research service provider or Cooperative Research Centre exceptions. Their R&D expenditure may be modest in dollar terms but technically significant. The Committee recommends retaining the threshold at $20,000 or providing an early-stage pathway.

The 10-year limitation on refundable offsets.

19. The 10-year rule uses the age of the entity as a proxy for the maturity of its R&D programme. This proxy is crude and will produce arbitrary outcomes. It will affect the cash flow, funding arrangements and employment decisions of loss-making companies that rely on the refundable offset as part of their funding architecture. The exposure draft contains no fresh start, reset or revival pathway. The Committee recommends that the time limit be reconsidered and that any extension, reset or revival pathways be narrowly defined and directed to genuinely new or revived R&D programmes.

Summary of principal recommendations

The Committee recommends that Treasury:

- **affirm that software development can qualify as an R&D activity where the statutory experimental criteria in section 355-25 of the ITAA 1997 are satisfied, and update published guidance for the proposed activity test, with the Commissioner issuing a public ruling on matters within the Commissioner's remit where appropriate;**
- **replace the broad affiliate and connected entity tracing rules in proposed table item 1A with a purpose-based anti-rebirthing test focused on whether the subsidised research project has previously been the subject of a refundable offset claim, and expressly exclude relationships that do not indicate continuity of that project;**

- **clarify the operation of proposed subsection 355-25(2A) and expressly preserve work directly necessary to formulate, conduct, observe and evaluate experiments;**
- **specify the activities that are to be excluded by means of a targeted exclusion list rather than a broad negative proposition;**
- **retain the minimum notional deductions threshold at $20,000 or provide an early-stage pathway, while preserving the existing exceptions for qualifying research service provider expenditure and Cooperative Research Centre contributions;**
- **reconsider the 10-year limitation on refundable offsets and, if it is retained, provide narrowly defined extension or reset pathways for entities that commence genuinely new R&D programmes;**
- **ensure that unrelated spousal businesses, venture capital portfolio companies and strategic corporate investors, and other relationships that do not indicate continuity of a subsidised research project, do not transfer an older commencement date to a newer entity through the affiliate and connected entity rules;**
- **permit a fresh refundable offset period for genuinely new ventures established by serial entrepreneurs, where the new venture conducts R&D that is not a continuation of a previously subsidised project;**
- **introduce a revival rule for stalled or failed projects, subject to objective indicators that distinguish genuine revival from artificial rebirthing;**
- **define the unit of R&D activity by reference to the experiment and adopt a project-based approach to the 10-year rule;**
- **publish distributional modelling of the combined effect of the reforms on different categories of claimant;**
- **base therapeutic goods and long-cycle sector eligibility on objective commercialisation characteristics rather than narrow sector labels;**
- **undertake and publish an employment impact analysis assessing the effect of the reforms on the location of research employment;**
- **issue detailed contemporaneous guidance before the commencement date, addressing in particular the new activity framework and the connected entity rules;**
- **provide transitional rules for existing projects, including rules for recharacterising work previously registered as supporting R&D activities under the current framework.**

Policy context

The RDTI is part of the funding architecture for loss-making technology businesses

20. Treasury should evaluate R&D tax policy by reference to its practical effect on three questions: where companies employ researchers, how they finance experimental activity, and whether projects continue in Australia or are relocated offshore.

21. For profitable companies, the RDTI reduces the after-tax cost of research expenditure. For loss-making companies, which includes most early-stage and growth-stage technology businesses, the refundable offset serves a fundamentally different function. It is a cash payment that forms part of the company's operating funding. The refundable offset is not merely a tax incentive for these businesses; it is a component of their funding architecture, alongside equity capital, grants, and revenue.

22. The practical significance of this distinction is that measures which reduce or introduce uncertainty into the refundable offset do not merely change the tax position of the company. They affect its ability to employ researchers, to continue experimental work, and to continue operating in Australia.

23. This context is important to the proper evaluation of the proposed reforms. A measure that is appropriate for profitable, established claimants may be inappropriate for loss-making, growth-stage claimants. A well-targeted RDTI should differentiate between these categories where necessary.

The interaction with the broader CGT reforms

24. As noted in the Earlier Submission, the RDTI reforms do not operate in isolation. The companies that claim refundable offsets are frequently the same companies whose founders, employees and early investors are affected by the proposed changes to the capital gains tax discount and the proposed IBCC.

25. Treasury should model and disclose the cumulative effect of the reforms across the RDTI, the CGT discount, the IBCC and the employee share scheme rules. Without that analysis, it is not possible to assess whether the package as a whole achieves the stated objective of supporting innovation.

Software Development Eligibility

Relevant consultation questions: Questions relating to the scope of eligible R&D activities

Software is the product, delivery mechanism, and principal asset for many technology businesses

26. For a large and growing segment of the Australian economy, including financial technology, health technology, cybersecurity, regulatory technology, climate technology, and platform businesses, software is not a tool used in support of other activities. It is the product, the delivery mechanism, the infrastructure, and the principal asset of the business.

27. The technical challenges encountered in developing software of this kind are frequently substantial. They include:

    (a) designing lending decision engines that must assess creditworthiness using non-traditional data sources where existing models do not provide reliable outcomes (thin-file assessment);

    (b) developing real-time payments orchestration systems that must operate across multiple banking systems, payment rails and regulatory environments with latency and reliability constraints that cannot be met by known approaches;

    (c) building cybersecurity and fraud detection systems that must identify patterns in real time across very large data sets where the adversarial environment means that existing solutions are continuously rendered ineffective;

    (d) creating regulatory technology that must interpret, apply, and update complex and frequently changing regulatory requirements in an automated manner;

    (e) engineering platform scalability where the system must handle orders of magnitude increase in concurrent users or transactions and existing architectures fail at the required scale; and

    (f) developing clinical and scientific software where algorithms must produce results of sufficient accuracy and reliability for health or scientific applications.

28. These examples may involve eligible R&D where the particular activity satisfies each element of subsection 355-25(1), is not excluded by subsection 355-25(2), and the other registration and deduction requirements are met. Technical difficulty or commercial novelty alone does not establish eligibility. The Committee is concerned that the current guidance will require revision to address the proposed removal of supporting activities.

The distinction between routine and experimental development

29. The Committee acknowledges that not all software development is R&D. Routine coding, adaptation of existing solutions to known requirements, and implementation of well-understood techniques do not involve the resolution of technical uncertainty and should not qualify.

30. However, there is a material distinction between routine development and experimental development. Section 355-25(1) of the ITAA 1997 requires experimental activities whose outcome cannot be known or determined in advance on the basis of current knowledge, information, or experience. The outcome can only be determined by applying a systematic progression of work based on principles of established science that proceeds from hypothesis to experiment, observation, and evaluation, and leads to logical conclusions. The activities must be conducted for the purpose of generating new knowledge. In *Moreton Resources Ltd v Innovation and Science Australia* [2019] FCAFC 120, the Full Court rejected an unduly narrow construction of subsection 355-25(1) in considering the application of existing technology in a new setting. Whether particular software work qualifies still depends on the statutory criteria and the specific activity. The exclusion for software developed, modified or customised for the dominant purpose of internal administration in paragraph 355-25(2)(h) must also be considered. The proposed amendments rename 'core R&D activities' as 'R&D activities' [Schedule #, items 37 to 41 and 46 to 48, subsection 355-25(1) and section 995-1 of the ITAA 1997].

Competing interpretations of administrative guidance

31. The Committee is concerned that competing interpretations of existing administrative guidance have created material uncertainty for software claimants. Published material includes Taxpayer Alert TA 2017/5 *(as amended)* and the Department of Industry, Science and Resources' current Software development sector guide for the R&D Tax Incentive, which gives examples of technical hurdles, hypothesis-driven testing and routine development. That guide addresses the existing distinction between core and supporting activities. It should be updated if the proposed removal of supporting activities is enacted, and should explain how its examples would apply under the amended test. Claimants may otherwise face uncertainty or disproportionate compliance costs.

32. The perception that administrative interpretation can become 'folklore' compounds this uncertainty: informal positions communicated through compliance activity that do not appear in published guidance but that shape claimant behaviour. This practice is inconsistent with the rule of law. The Business Law Section's guiding principles require that laws be accessible, navigable, readable and intelligible, and that executive power be exercised within appropriate limits. Administrative positions that are communicated only through compliance activity fail that standard. The Committee recommends that all material administrative positions be formalised in published guidance.

Recommendation

The Committee recommends that:

- **Treasury confirm in the explanatory materials that software development can qualify where subsection 355-25(1) is satisfied and none of the exclusions in subsection 355-25(2), including paragraph (h), applies;**
- **worked examples addressing the amended test be published that illustrate the application of the statutory test to software development in areas including software architecture, algorithms, security, integrations, and scalability; and**
- **all material administrative positions on software eligibility be formalised in published guidance and not communicated solely through compliance activity; and**
- **the Commissioner of Taxation and Industry Innovation and Science Australia (Board) review TA 2017/5 and the Department's current software guidance in light of the amendments. The Commissioner should consider a public ruling under Division 357 of Schedule 1 to the *Taxation Administration Act 1953 on matters within the Commissioner's administration; a ruling cannot replace the Board's statutory role in registration and activity findings.***

Removal of Supporting Activities

Relevant consultation questions: Questions relating to the redefinition of eligible R&D activities

The amendment creates ambiguity without corresponding gain

33. The exposure draft proposes to remove the concept of 'supporting R&D activities' as a separate category. Under section 355-25 of the ITAA 1997, core R&D activities are experimental activities meeting the statutory criteria described above. Under section 355-30, supporting R&D activities are activities directly related to core R&D activities. Where an activity falls within subsection 355-25(2), produces goods or services, or is directly related to producing goods or services, subsection 355-30(2) additionally requires the dominant purpose of supporting core R&D activities. Subsection 355-30(3) separately limits certain gambling- and tobacco-related activities to a sole harm minimisation purpose. The proposed amendments would rename 'core R&D activities' as 'R&D activities' and introduce a new subsection 355-25(2A) [Schedule #, item 42, subsection 355-25(2A) of the ITAA 1997] providing that an activity is not an R&D activity merely because it is directly related to, or supportive of, another R&D activity. The repeal of sections 355-20 and 355-30 [Schedule #, items 36 and 43] removes the existing definitions and provisions relating to supporting R&D activities. Item 47 redirects the definition of 'R&D activities' in subsection 995-1(1) from section 355-20 to section 355-25. Items 46 and 48 repeal the definitions of 'core R&D activities' and 'supporting R&D activities'.

34. The Committee's concern is twofold.

35. **The explanatory materials expressly state that expenditure on supporting activities will cease to be eligible.** Practitioners and claimants will need to recharacterise existing activities under the narrower framework without clear guidance on whether preparatory work or work integral to an experiment can itself satisfy subsection 355-25(1). This will increase compliance costs, particularly for smaller claimants, without improving the targeting of the incentive.

36. **Because the Government intends to narrow the eligible base,** the legislation or explanatory materials should specify the intended treatment of common categories of preparatory, experimental and ancillary work. A broad negative proposition, namely that an activity does not qualify merely because it supports another qualifying activity, does not provide sufficient guidance to claimants or their advisers. It invites administrative resistance to legitimate claims and creates an environment in which eligibility is determined less by the statute and more by the disposition of the reviewing officer. This outcome is inconsistent with the principle that executive power should be exercised within appropriate limits and subject to appropriate accountability mechanisms.

The background research paradox

37. The Committee draws particular attention to what might be described as the background research paradox. In order to formulate a testable hypothesis, which is an element of the systematic progression of work required by the statutory test, a researcher must typically undertake a review of the existing state of knowledge. A literature review may help formulate the hypothesis and identify the limits of existing knowledge; it is not, solely for that reason, itself an experimental activity.

38. Under the proposed framework, it is unclear whether this preparatory work qualifies as an R&D activity in its own right. The work is conducted for the purpose of establishing whether there is a hypothesis to test. The Department's current supporting activities guidance gives a literature review to refine a hypothesis as an example of a potentially eligible supporting activity. Under the proposal, such work will cease to qualify on that basis alone; it must itself form part of an activity satisfying subsection 355-25(1). Treasury should explain where that boundary falls.

The breadth of core activity and administrative resistance

39. The Committee is also concerned that, in practice, the removal of the supporting activities category may encourage administrative resistance to the characterisation of a broad range of genuinely necessary experimental work as R&D activities. Data collection, prototype fabrication, test environments, instrumentation and observation may form part of the experimental process, depending on how the relevant activity is identified and conducted. Without clear guidance, there is a risk that these activities will be treated as excluded merely because they can be characterised as 'supporting' the experimental hypothesis. This concern is reinforced by the amendment to subsection 28D(5) of the *Industry Research and Development Act 1986*. The explanatory materials explain that the amendment is necessary because the significant scientific link test in subsection 28D(3) would otherwise capture supporting

R&D activities that are no longer eligible. This indicates that the drafters accepted that the removal has substantive reach beyond nomenclature.

Recommendation

The Committee recommends that:

- **work directly necessary to formulate, conduct, observe and evaluate experiments be expressly preserved as eligible R&D activity;**
- **if the Government intends to exclude peripheral expenditure, those activities be specified directly by means of a targeted exclusion list, rather than relying on a broad negative proposition;**
- **the explanatory materials confirm that work satisfying subsection 355-25(1) in its own right remains eligible, while work that qualifies only through its relationship to a core activity under existing section 355-30 will cease to be eligible; and**
- **the unit of R&D activity be defined by reference to the experiment, so that all activities that form part of the systematic progression of work from hypothesis through experiment to conclusion are treated as a single eligible activity.**

Ten-year limitation on refundable offsets

Relevant consultation questions: Questions relating to the 10-year refundable offset limitation

Correct characterisation of the measure

40. The proposed 10-year limitation does not remove access to the RDTI entirely after 10 years. The non-refundable offset remains available. However, the practical difference between a refundable and a non-refundable offset is material for loss-making companies. A refundable offset can yield a cash refund after application against outstanding tax liabilities. A non-refundable offset cannot produce an immediate cash refund, although unused amounts may be carried forward subject to the applicable tax offset rules. For a company that is not yet profitable, the non-refundable offset has no immediate cash value. Under proposed table item 1A in subsection 355-100(1), an R&D entity with aggregated turnover of less than $50 million retains the highest offset rate, 23 percentage points above its corporate tax rate, once any day during the income year occurs on or after the tenth anniversary of the 'start day', but on a non-refundable basis. Item 1A is triggered for the whole income year if the tenth anniversary falls on any day in that year, including the last day. The refundable offset in table item 1 is displaced because item 1A applies [Schedule #, items 4 to 6].

41. The correct characterisation of the measure is therefore not that it removes the RDTI after 10 years, but that it materially changes the cash profile of the incentive. For loss-making companies, this change is functionally equivalent to removing the incentive altogether.

Cash flow and survival implications

42. The refundable offset is a principal source of operating cash for loss-making technology companies. For many of these companies, the refundable offset represents a significant proportion of their annual cash receipts. The loss of refundability will, for some companies, create a cash shortfall that cannot be met from other sources.

43. The Committee is concerned that the 10-year rule does not adequately account for the fact that many technology businesses require more than 10 years to reach profitability. This is particularly the case for businesses developing complex products for regulated markets, businesses that must achieve significant scale before unit economics become positive, and businesses in sectors with long commercialisation cycles.

Investment and capital raising

44. Investors take the refundable offset into account when valuing early-stage companies and when structuring investment. The loss of refundability will reduce the effective runway that each funding round provides and may require companies to raise additional capital solely to replace the cash that the refundable offset previously provided.

45. This has particular significance when considered together with the proposed changes to the capital gains tax regime. If both the RDTI refundable offset and the CGT discount are reduced or removed for the same class of companies, the cumulative effect on the attractiveness of early-stage investment in Australian technology businesses may be substantial.

Employment implications

46. R&D expenditure in the technology sector is predominantly employment expenditure. Research and development in software, in particular, is labour-intensive. The principal cost is the remuneration of the researchers, engineers and scientists who conduct the experimental work.

47. A reduction in the cash available to fund research employment will, in many cases, translate directly into a reduction in the number of researchers employed in Australia. Companies that lose access to the refundable offset will face a choice between reducing headcount, relocating research functions to lower-cost jurisdictions, or raising additional capital to replace the lost cash.

48. The Committee considers that Treasury should model and disclose this employment effect before the legislation is enacted.

Why age is the wrong proxy

49. The 10-year rule uses the age of the entity as a proxy for the maturity of its R&D programme. This proxy is crude and will produce arbitrary outcomes. The ‘start day’ is defined as the earlier of the day the R&D entity, or another entity mentioned in subsection 355-100(6), first started carrying on an enterprise, or the day the R&D

entity, or another entity mentioned in subsection 355-100(6), first registered for R&D activities under Part III of the *Industry Research and Development* Act *1986* [Schedule #, item 6, table item 1A in subsection 355-100(1) of the ITAA 1997]. The tracing means that the start day may be that of a connected entity or affiliate, not only that of the R&D entity itself. The measure is therefore not purely a test of the claimant's own age. Treasury should clarify when the relationship to another entity is tested and whether a later change in ownership can bring an earlier start day into the calculation.

50. Research and development activity does not cease after a decade. Many of Australia's most significant research-intensive businesses have been conducting experimental work for substantially longer than 10 years. The age of the entity indicates when the business was established, not whether its current R&D programme is mature, productive, or approaching commercialisation.

51. A company that pivots to an entirely new research programme in its ninth year of operation would, under the proposed rule, have only the remainder of the period before the first income year containing its tenth anniversary in which to receive a refundable offset for that new programme. A company that has been profitable for years and has never claimed a refundable offset might, upon entering a loss-making phase due to a new research initiative, find that its 10-year period has already elapsed.

Recommendation

The Committee recommends that:

- **Treasury reconsider the 10-year limitation on refundable offsets, having regard to its effect on cash flow, employment, and investment in loss-making research-intensive companies;**
- **if the time limitation is retained, extension and reset pathways be provided for entities that commence genuinely new R&D programmes or that experience commercially justifiable delays in commercialisation;**
- **the measurement period be applied to the R&D activity or project, not to the entity, so that a company undertaking a genuinely new programme of experimental work is not penalised for having existed for longer than 10 years; and**
- **Treasury publish distributional modelling of the effect of the 10-year rule on different categories of claimant, including by sector, entity age, turnover, and refundable offset value.**

Connected Entities and Affiliates

Relevant consultation questions: Questions relating to the operation of the 10-year rule and connected entity tracing

The overbreadth of the association tests

52. The Committee regards the connected entity and affiliate tracing rules as the most technically significant drafting issue in the exposure draft. The proposed table item 1A would determine the commencement date of an entity's 10-year refundable offset period by reference to the earlier of the entity's own commencement date or the commencement date of its affiliates and connected entities. Proposed subsection 355-100(6) [Schedule #, item 17] defines the 'other entities' for the purposes of table item 1A as: (a) an entity connected with the R&D entity; and (b) an affiliate of the R&D entity or an entity of which the R&D entity is an affiliate.

53. The concepts of 'connected entity' and 'affiliate' in the income tax law are broad, but they operate through specific statutory tests. 'Connected with' in section 328-125 of the ITAA 1997 turns on control, including a 40 per cent control percentage test and, for discretionary trusts, control by reference to the trustee's conduct or prior distributions. Where the control percentage is at least 40 per cent but less than 50 per cent, subsection 328-125(6) permits the Commissioner to determine that the putative controller does not control the entity if another entity or entities control it. 'Affiliate' in section 328-130 turns on whether an individual or company acts, or could reasonably be expected to act, in accordance with the entity's directions or wishes, or in concert with the entity, in relation to the affairs of its business. Subsection 328-130(2) provides that a person is not an affiliate merely because of the nature of a business relationship. These tests can nevertheless capture relationships beyond direct ownership, including common control and some relationships of influence. The result is that the 10-year period of one entity may be determined by reference to the history of another business, even where the businesses have no connection with the subsidised R&D programme.

54. The Committee considers that this is overbroad and will produce unintended outcomes. The following worked examples illustrate the concern.

Worked examples

Example 1: Spouse's unrelated business

55. A software engineer founds a fintech company in 2029. The engineer's spouse has operated an unrelated retail business, for example a florist, since 2015. The spouse, if carrying on the retail business as a sole trader, does not automatically become an affiliate of the fintech company merely because of the marriage or shared household finances; the business itself is not a separate entity. Section 328-130 has no spousal presumption. The factual affiliate test could apply only if the spouse acts, or could reasonably be expected to act, in accordance with the fintech company's directions or wishes, or in concert with it, in relation to the affairs of the spouse's retail business. The example does not establish those facts. The exposure draft contains no express carve-out for this situation. The fintech company could therefore face uncertainty

about whether its 10-year refundable offset period is measured from 2015 rather than 2029. The special rule in section 152-47 of the ITAA 1997 concerns the small business CGT concessions and does not, of itself, apply to this proposal.

56. This uncertainty is inconsistent with the policy intent if the florist has no connection to the fintech company's R&D programme. The spousal relationship alone does not indicate any risk of artificial rebirthing. The concern is that the breadth of the statutory test and the absence of an express carve-out may require claimants to resolve a factual affiliate question unrelated to the subsidised project.

Example 2: Venture capital portfolio companies

57. A venture capital fund holds interests in 30 portfolio companies. One portfolio company was established in 2016. Another portfolio company, operating in an entirely different sector and conducting unrelated R&D, is established in 2030. A fund holding less than 40 per cent of each portfolio company would not, without more, make the portfolio companies connected with each other. If the same fund entity controls both companies under section 328-125, including by holding interests carrying at least 40 per cent of the relevant distribution or voting rights in each, the companies may be connected because they are controlled by the same third entity. An appointment right or contractual influence alone does not establish the statutory control percentage. The Commissioner's discretion in subsection 328-125(6) may apply where a percentage is at least 40 per cent but less than 50 per cent. Subject to those qualifications, the older company's commencement date may determine the newer company's refundable offset period.

58. This outcome would materially reduce the attractiveness of venture capital investment in Australian technology companies. It would create a disincentive for venture funds to invest in companies at different stages of development and would penalise the diversification that characterises a well-functioning venture capital market.

Example 3: Strategic corporate investor

59. A telecommunications company acquires a 45 per cent interest in a cybersecurity start-up. The telecommunications company has been operating for over 40 years. Assuming the shares carry corresponding voting or distribution rights, the 45 per cent holding meets the prima facie control percentage in section 328-125 of the ITAA 1997, subject to the Commissioner's discretion in subsection 328-125(6). A 30 per cent holding alone would not meet the direct control threshold, although affiliates' holdings and other statutory routes to connection must also be considered. Board representation or contractual influence alone does not establish direct control under subsection 328-125(2). Where the statutory connection is established, the strategic investment may cause the start-up's refundable offset period to be measured from the telecommunications company's commencement date.

60. This outcome would discourage strategic investment in Australian technology companies by large corporates, which is one of the principal mechanisms by which start-ups access customers, distribution, and industry expertise.

Example 4: Serial entrepreneur

61. A successful founder sold a previous company after 12 years. The founder starts an entirely new venture in a different sector, conducting unrelated R&D. A founder who has fully exited the earlier company would not ordinarily create an affiliate or connected entity relationship with the new venture. The concern arises if the founder's continuing connection with the earlier company, for instance retained interests carrying the necessary distribution or voting rights in both companies, makes them connected under section 328-125. A continuing directorship in the earlier company, without more, does not itself make the companies connected or affiliates. The individual founder's own earlier commencement date is not automatically attributed to the new company merely because the founder controls it. If the two companies are connected, the new venture's refundable offset period may already have expired before it commences operations.

62. Serial entrepreneurs are among the most productive participants in the innovation economy. They bring experience, networks, capital, and expertise to each successive venture. A rule that penalises serial entrepreneurship is inconsistent with the objective of encouraging R&D in Australia.

A purpose-based anti-rebirthing approach is preferred

63. The Committee acknowledges that there is a legitimate integrity concern underlying the tracing rules: the risk that a company approaching the end of its 10-year period might 'rebirth' its R&D programme in a new entity to obtain a fresh period of refundable offsets.

64. The proposed solution is disproportionate to the mischief it seeks to address. The broad affiliate and connected entity tracing rules capture a wide range of ordinary commercial relationships that have no connection to artificial rebirthing. The Committee's guiding principles require proportionality between the regulatory response and the conduct it targets. The tracing rules fail that standard.

65. The Committee recommends that the broad tracing rules be replaced with a purpose-based continuity test. Under such a test, the relevant question would be whether the R&D project that is the subject of the refundable offset claim has previously been the subject of a claim by another entity. If the project is genuinely new, the entity should be entitled to a fresh 10-year period regardless of its connections to other entities.

Recommendation

The Committee recommends that:

- **the broad affiliate and connected entity tracing rules in proposed table item 1A be replaced with a purpose-based anti-rebirthing test focused on whether the subsidised research project has previously been the subject of a refundable offset claim;**
- **unrelated spousal businesses, venture capital portfolio companies, strategic corporate investors and other relationships that do not indicate continuity of a subsidised research project be excluded from the tracing rules;**
- **a fresh refundable offset period be available for genuinely new ventures established by serial entrepreneurs, provided the new venture conducts R&D that is not a continuation of a previously subsidised project; and**
- **if the tracing rules are retained, the explanatory materials provide detailed guidance on the application of the affiliate and connected entity tests to the common commercial relationships described in the worked examples above.**

Failed, stalled and revived projects

Relevant consultation questions: Questions relating to the 10-year rule and project continuity

Policy should distinguish artificial rebirthing from substantive revival

66. The Committee considers that the 10-year limitation must account for the commercial fact that research projects frequently fail, stall or are abandoned. Different teams, new owners, or materially different approaches may subsequently revive those projects.

67. A rule that treats a revived project as a continuation of the original project for the purposes of the 10-year period will discourage the revival of promising but stalled research. This is particularly problematic in sectors where initial failure is expected and where the knowledge generated by the original project is valuable precisely because it identifies approaches that do not work.

Indicators of genuine revival

68. The Committee recommends that the legislation recognise genuine revival by reference to objective indicators, including:

    (a) a change in the controlling ownership or management of the project;

    (b) a material change in the experimental approach or hypothesis;

(c) a significant period of inactivity (for example, two or more income years in which no R&D expenditure was incurred in relation to the project);

(d) new investment specifically directed to the resumed project; and

(e) the availability of new knowledge, techniques or technologies that were not available when the project was originally undertaken.

Insolvency should not be the only gateway

69. The exposure draft and explanatory materials contain no fresh start, revival or insolvency pathway, and no rule permitting a new refundable offset period following acquisition of intellectual property from an insolvent entity. The only express extension of the ten-year anniversary in the exposure draft is the fifteen-year period for qualifying therapeutic goods R&D in subsections 355-100(4) and (5) of the ITAA 1997. Insolvency would in any event be too narrow a gateway if such a pathway were adopted. It is a consequence of financial distress, not a reliable indicator of the quality of the underlying research. A project may stall because of a funding gap, a change in market conditions or a strategic decision to pursue a different opportunity, none of which necessitates insolvency.

70. The Committee recommends that a revival rule be introduced that permits a fresh refundable offset period for genuinely revived projects, subject to the objective indicators described above.

New Projects Within Existing Companies

Relevant consultation questions: Questions relating to the scope of the 10-year rule

Whether the 10-year period applies to the company or the R&D activity

71. The exposure draft measures the 10-year period by reference to the entity: the earlier of the date the entity first carried on an enterprise or first registered for R&D activities. This means that the age of the entity, not the age of the R&D programme, determines access to the refundable offset. Under proposed table item 1A [Schedule #, item 6], the start day is measured by reference to the R&D entity or another entity mentioned in subsection 355-100(6). The rule may therefore operate by reference to the history of a connected entity or affiliate, regardless of the age of the claimant's own R&D project.

72. The Committee considers that this entity-based approach produces arbitrary outcomes. A company that has been operating for 11 years but commences a genuinely new R&D programme in a field unrelated to its previous activities will have no access to refundable offsets for that programme. A newly incorporated company conducting the same research may have a new 10-year period, provided no connected entity or affiliate supplies an earlier start day under the proposed rule.

73. This creates a perverse incentive for companies to incorporate new entities solely for the purpose of conducting R&D, which directly undermines the simplicity and integrity objectives of the reform.

A project-based rule is conceptually better targeted

74. The Committee acknowledges that a project-based rule would be more complex to administer than an entity-based rule. However, a project-based rule is conceptually better targeted at the policy objective. The question that the 10-year rule seeks to answer is whether the R&D programme is sufficiently mature that refundable support is no longer necessary. The age of the entity is a poor proxy for the maturity of a specific R&D programme.

75. If a project-based approach is considered too administratively complex, the Committee recommends that the entity-based rule be supplemented with an extension or reset mechanism for entities that commence genuinely new programmes of R&D activity after their initial 10-year period has elapsed.

Minimum Expenditure Threshold ($50,000)

Relevant consultation questions: Questions relating to the minimum claim threshold

Effect on very early ventures and bootstrapped projects

76. The proposed increase in the minimum annual R&D expenditure threshold from $20,000 to $50,000 may exclude very early-stage innovators whose total specified notional deductions fall below $50,000, even if their work is technically significant, unless they have expenditure qualifying for the exceptions in subsection 355-100(2) [Schedule #, items 11 to 13, subsection 355-100(2) of the ITAA 1997].

77. This is particularly relevant to bootstrapped ventures in the technology sector, where a small team of founders may conduct substantial experimental work at relatively low cost. In software development, the principal cost of R&D is the time of the researchers. A team of two or three founders working part-time on an experimental project may incur R&D expenditure below $50,000 while conducting work that is technically and commercially significant.

Interaction with the software sector

78. The interaction between the increased threshold and the software sector is of particular concern. Software development can produce technically significant outcomes at relatively low cost because the infrastructure costs are minimal. People, rather than expensive equipment or materials, carry out the experimental work. A rule that uses expenditure as a proxy for the significance of R&D activity is poorly calibrated for the software sector.

Recommendation

The Committee recommends that:

- **the minimum annual expenditure threshold be retained at $20,000; or**
- **if the threshold is increased, an early-stage pathway be provided for entities in their first three years of R&D activity, permitting those entities to claim with expenditure below $50,000; or**
- **at a minimum, the increase be phased over two or three income years to allow early-stage ventures time to adjust.**

Increase in refundable turnover threshold

Relevant consultation questions: Questions relating to the turnover threshold

79. The Committee welcomes the increase in the refundable turnover threshold from $20 million to $50 million [Schedule #, items 1 and 3, section 355-1 and table item 1 in subsection 355-100(1) of the ITAA 1997]. Subject to the proposed anniversary test and the existing exempt-entity control restriction, this change will extend refundable offset eligibility to some growth-stage companies that have outgrown the current turnover threshold.

80. However, the Committee notes that the practical beneficiary population may be narrower than the headline suggests when the threshold increase is considered together with the 10-year limitation. A company with turnover between $20 million and $50 million may have been operating for a sufficient period that its 10-year refundable offset period has already elapsed or is close to expiring. In that case, the increased threshold provides a theoretical benefit that is not realisable in practice.

81. The Committee recommends that Treasury model the combined effect of the turnover threshold increase and the 10-year rule on the actual population of R&D claimants and publish that modelling to inform the consultation process.

Therapeutic goods and long-cycle sectors

Relevant consultation questions: Questions relating to the 15-year period for therapeutic goods entities

82. The Committee welcomes the recognition, in the proposed 15-year period for entities conducting R&D activities relating to therapeutic goods, that some sectors have inherently longer commercialisation cycles. The extended 15-year period applies only if the R&D entity is or was registered under section 27A of the *Industry Research and Development Act 1986* (IRD Act) for one or more R&D activities for the income year in which the start day occurred or one of the next nine income years, and the activities were conducted for the dominant purpose of generating new knowledge about therapeutic goods or the therapeutic use of therapeutic goods within the meaning of the Therapeutic Goods Act 1989. An entity may apply for a dominant

purpose finding under section 28EA of the IRD Act. An application must generally be made within 10 months after the end of the income year, subject to a further period allowed by Industry Innovation and Science Australia (Board). A finding made within four years after the end of the relevant income year binds the Commissioner for assessments under sections 355-705 and 355-710 of the ITAA 1997. The proposed text does not make an affirmative Board finding an express precondition of the 15-year modification. Findings and refusals to allow a further period are reviewable decisions under Division 5 of the IRD Act by reason of new table items 13A and 13B in section 30A. The Committee recommends that Treasury clarify how the tracing in subsection 355-100(6) interacts with both the 15-year anniversary and the requirement to have registered in the start-day income year or one of the next nine income years. An older connected entity's start day may make that registration condition impossible for a younger claimant to meet, even if its own therapeutic goods work begins much later [Schedule #, items 17, 20, 23, 26, 28 and 30].

83. However, the Committee considers that the extended period should not be confined to a narrow sector label. The characteristics that justify a longer period, including lengthy regulatory approval processes, extended clinical or field testing, long development cycles and delayed revenue, are not unique to therapeutic goods. They are present in:

    (a) medical devices and diagnostics that fall outside the statutory definition of therapeutic goods;

    (b) agricultural biotechnology;

    (c) advanced materials and manufacturing;

    (d) clean energy and climate technology;

    (e) space and defence technology; and

    (f) deep technology hardware.

84. The Committee recommends that the extended period be available to any entity that can demonstrate objective commercialisation characteristics justifying a longer development cycle, rather than being confined to entities whose qualifying R&D is conducted for the dominant purpose of generating new knowledge about therapeutic goods, or their therapeutic use, within the meaning of the *Therapeutic Goods Act 1989*. The exposure draft does not require registration of the goods under that Act.

Australian employment and location decisions

Relevant consultation questions: Questions relating to the economic effect of the reforms

The RDTI incentivises employing people in Australia

85. The RDTI operates, in practice, as an incentive to employ researchers and conduct experimental work in Australia. Eligible R&D expenditure can include salaries and wages attributable to registered activities conducted in Australia, subject to the statutory requirements. Employee residence is not itself a condition of eligibility; overseas activities require separate consideration under the overseas finding rules.

86. A reduction in the value or certainty of the RDTI changes the relative cost of employing researchers in Australia compared to other jurisdictions. For multinational technology businesses, the decision about where to locate research teams is influenced by a range of factors, including the availability of talent, the cost of employment, the regulatory environment and the tax treatment of R&D expenditure. The RDTI is a significant factor in that assessment.

Loss of refundability can make offshore hiring more attractive

87. The Committee is concerned that the loss of refundability after 10 years, combined with the uncertainty created by the changes to the activity framework, may make it more attractive for companies to locate or relocate research functions outside Australia.

88. This concern is particularly significant for technology companies that rely on software engineers to conduct their research. Software engineers can work remotely. The work does not require physical proximity to a laboratory, factory, or field site. A company that loses access to refundable offsets may find it more cost-effective to employ engineers in jurisdictions that offer more generous or more certain R&D support.

Request for employment impact analysis

89. The Committee recommends that Treasury undertake and publish an employment impact analysis assessing the effect of the proposed reforms on the location of research employment. This analysis should consider the combined effect of:

    (a) the 10-year limitation on refundable offsets;

    (b) the removal of supporting activities;

    (c) the increase in the minimum expenditure threshold;

    (d) the broader capital gains tax reforms and the IBCC; and

    (e) the comparative R&D tax regimes in competitor jurisdictions.

Administration, Guidance and Litigation

Relevant consultation questions: Questions relating to the administration of the RDTI

Need for contemporaneous guidance before commencement

90. The proposed reforms would commence for income years beginning on or after 1 July 2028. The Committee considers that detailed guidance must be published well before the commencement date. Claimants need to understand the new framework before they plan and conduct their R&D activities for the first income year to which the reforms apply.

91. In particular, guidance is needed on:

    (a) the scope of R&D activities under the new framework, including the practical effect of the removal of supporting activities;

    (b) the application of the connected entity and affiliate tracing rules, with worked examples covering common commercial relationships;

    (c) the transitional rules for existing projects, including rules for recharacterising activities previously registered as supporting R&D activities; and

    (d) the application of the 10-year rule to entities that have already been carrying on an enterprise or registered for R&D before commencement.

Cost asymmetry between large and small claimants

92. The Committee is concerned that the complexity of the reforms will disproportionately affect smaller claimants. Large companies can absorb the compliance costs that a complex new framework imposes. Small companies, which may have only one or two research staff and limited access to specialist tax advice, face a proportionally greater burden.

93. This cost asymmetry is inconsistent with the stated objective of supporting R&D across the economy. It is also inconsistent with the principle that laws should be accessible and intelligible to those whose activities they govern. The Committee recommends that Treasury provide measures to reduce the compliance burden on smaller claimants, including simplified registration procedures, template documentation, and safe harbours for claims below a specified threshold.

Administrative interpretation should not become folklore

94. The Committee reiterates its concern, noted in the context of software eligibility, that administrative interpretation can become ‘folklore’: informal positions communicated through compliance activity that shape claimant behaviour without being reflected in published guidance. The Committee considers that this is inconsistent with the rule of law and with the legitimate expectations of taxpayers.

95. The Commissioner of Taxation and Industry Innovation and Science Australia (Board) should publish material administrative positions in guidance; registration and

activity findings should remain subject to the statutory review processes that apply to them. The Committee recommends that the Commissioner and the Board publish and periodically update guidance on the operation of the RDTI. They should formalise their settled administrative positions, including through a public ruling or determination where appropriate.

Transition to the new activity framework

Relevant consultation questions: Questions relating to transitional arrangements

Existing projects need rules for recharacterising work

96. Companies that currently register activities as both core R&D activities and supporting R&D activities will need to recharacterise their work under the new framework from the first income year to which the reforms apply. Items 74 to 76 of Schedule # address assessments, decisions and findings across the transition. Subitem 74(2) preserves the former rules for assessments of later income years to the extent they relate to supporting activities conducted, or registration for an income year commencing, before 1 July 2028. Item 75 governs specified registration decisions and findings made on or after commencement. Subitem 76(2) removes the binding effect of a relevant finding to the extent it would require assessment of an activity that ceases to qualify; subitem 76(3) preserves specified historical supporting activities and registrations. Subitem 76(4) translates findings and registrations concerning core activities into findings and registrations concerning R&D activities, and subitem 76(5) preserves the binding effect of specified findings concerning overseas core activities [Schedule #, items 74 to 76]. The exposure draft contains no transitional rule for Part 1. The ten-year start day is therefore determined by reference to enterprise commencement or registration occurring before 1 July 2028. The explanatory materials should confirm that outcome. Claimants should be alerted to the loss of binding effect under subitem 76(2).

97. The Committee is concerned that the exposure draft and explanatory materials do not provide sufficient guidance on how claimants are to manage this transition. In particular:

    (a) activities conducted in income years commencing on or after 1 July 2028 that would previously have been registered as supporting activities must be assessed against the amended definition, rather than assuming that an earlier supporting-activity registration remains effective for them; the scope of subsection 355-25(2A) requires explanation [Schedule #, items 42 and 74 to 76];

    (b) documentation prepared under the current framework may not address the criteria that will be relevant under the new framework; and

    (c) compliance reviews of claims for transitional income years may apply standards that were not known or ascertainable at the time the activities were planned and conducted. The concern is reinforced by the Commissioner's published administrative practice on record keeping and substantiation for R&D claims. Retrospective application of new evidentiary expectations would be inconsistent with that guidance.

Historical evidence expectations should reflect the law in force at the time

98. The Committee recommends that the transitional rules expressly provide that, for activities planned or commenced before the commencement date, evidence and documentation standards should reflect the law in force at the time the activities were planned and conducted. The Commissioner's published administrative practice on record keeping and substantiation supports that approach. The Commissioner should not apply retrospectively the evidentiary expectations of a legislative framework that did not exist when the claimant made its decisions.

99. The Committee also recommends that a transitional safe harbour be provided for the first two income years following commencement, during which claims for continuing experimental projects receive transitional relief where the only barrier is the removal of eligibility for activities previously registered as supporting activities. This would require an express extension beyond the current limited protection in items 74 to 76.

Summary of Recommendations

The Committee recommends that Treasury:

1. **affirm that software development can qualify as an R&D activity where the statutory experimental criteria in section 355-25 of the ITAA 1997 are satisfied, and update published guidance for the amended activity test, with a public ruling on issues within the Commissioner's remit where appropriate;**

2. **provide worked examples for the amended test illustrating the application of the statutory test to software development in areas including software architecture, algorithms, security, integrations, and scalability;**

3. **formalise all material administrative positions on software eligibility in published guidance, with a public ruling on matters within the Commissioner's remit where appropriate;**

4. **expressly preserve work directly necessary to formulate, conduct, observe and evaluate experiments as eligible R&D activity;**

5. **if the Government intends to exclude peripheral expenditure, specify those activities directly by means of a targeted exclusion list;**

6. **define the unit of R&D activity by reference to the experiment;**

7. **reconsider the 10-year limitation on refundable offsets and, if it is retained, provide narrowly defined extension or reset pathways;**

8. **apply the measurement period to the R&D activity or project rather than to the entity;**

9. **replace the broad affiliate and connected entity tracing rules with a purpose-based anti-rebirthing test focused on the subsidised research project, and expressly exclude relationships that do not indicate continuity of that project;**

10. **ensure that unrelated spousal businesses, venture capital portfolio companies and strategic corporate investors, and other relationships that do not indicate continuity of a subsidised research project, do not transfer an older commencement date to a newer entity;**

11. **permit a fresh refundable offset period for genuinely new ventures established by serial entrepreneurs, where the new venture conducts R&D that is not a continuation of a previously subsidised project;**

12. **introduce a revival rule for stalled or failed projects, subject to objective indicators that distinguish genuine revival from artificial rebirthing;**

13. **retain the minimum notional deductions threshold at $20,000 or provide an early-stage pathway, while retaining the research service provider and Cooperative Research Centre exceptions;**

14. **model the combined effect of the turnover threshold increase and the 10-year rule on the actual population of R&D claimants;**

15. **base eligibility for the extended 15-year period on objective commercialisation characteristics rather than narrow sector labels;**

16. **undertake and publish an employment impact analysis;**

17. **issue detailed contemporaneous guidance before the commencement date;**

18. **provide measures to reduce the compliance burden on smaller claimants;**

19. **provide transitional rules for existing projects, including rules for recharacterising work previously registered as supporting R&D activities;**

20. **provide a transitional safe harbour for the first two income years following commencement; and**

21. **establish ongoing consultation and review mechanisms to ensure that the reformed RDTI is operating as intended.**

Conclusion

100. The Committee supports the policy objective of ensuring that Australia's tax system encourages genuine private-sector research and development expenditure. An effective and well-targeted RDTI is important to Australia's capacity to attract and retain research talent, develop commercially significant intellectual property and compete for globally mobile research investment.

101. However, the package of reforms, as currently drafted, does not achieve that objective. The restrictive elements of the package introduce uncertainty, overbreadth and disproportionality that are inconsistent with the Business Law Section's guiding principles of certainty, predictability and fairness.

102. The positive elements of the package, including the increases in offset rates, the raised turnover threshold, the increased expenditure cap and the reduced intensity threshold, are welcome and should improve the practical operation of the RDTI for many claimants.

103. The restrictive elements include the 10-year limitation on refundable offsets, the overbroad connected entity and affiliate tracing rules, the removal of supporting activities, and the increased minimum expenditure threshold. These measures risk undermining the stated objectives. They may also reduce the accessibility and certainty of the incentive for genuine research and development, particularly in the technology sector.

104. The Committee is particularly concerned that the connected entity and affiliate tracing rules, in their current form, will produce unintended outcomes for a wide range of ordinary commercial relationships. These include spousal businesses, venture capital portfolio companies, strategic corporate investors, and serial entrepreneurs. The Committee regards this as the most technically significant drafting issue in the exposure draft. It urges Treasury to adopt a purpose-based anti-rebirthing approach.

105. Treasury has not modelled the cumulative effect of the RDTI reforms, the capital gains tax changes and the IBCC on the innovation ecosystem. Without that analysis, it is not possible to assess whether the package as a whole supports or undermines Australia's capacity to create, fund, scale and retain innovative businesses. The Committee considers this a significant omission.

106. The Committee recommends that Treasury undertake further targeted consultation and revise the proposed design before legislation is introduced. A successful RDTI must provide certainty at the time R&D is planned and conducted, support both financial capital and human capital, incentivise the employment of researchers in Australia, and ensure that Australia remains an attractive jurisdiction in which to conduct research and development.

107. The Committee would be pleased to engage further with Treasury on the detailed design of the proposed reforms to the Research and Development Tax Incentive.

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