

29 May 2015

### **The Group of Eight Submission to Re:think: the Tax Discussion Paper**

The Group of Eight (Go8) welcomes the opportunity to comment on *Re:think: the Tax Discussion Paper*. Please note that this submission represents the views of the Go8 network; member universities may also make their own, more detailed submissions.

The Go8 agrees that the nature and structure of the Australian economy is changing, and that it is timely to review the tax system to ensure coherence within a globally-connected, twenty-first century context. This submission will focus on the following issues raised in the discussion paper, which are pertinent to the effective operation of the higher education and research sectors both now and into the future:

- The Research and Development tax incentives
- Broadening the GST
- Dividend Imputation
- Treatment of the Not For Profit sector
- How Australian taxation incentives might better encourage innovation and entrepreneurship activities.

The Go8 also welcomes the broad nature of the *Discussion Paper*, especially the invitation to raise additional issues that are outside its scope. The Go8 would like to make the following broad points that should be considered as part of the taxation review:

- The tax review is one of a suite of government processes currently underway that have implications for the national innovation system. The *Boosting Commercial Returns from Research; Industry, Innovation and Competitiveness Agenda* and Federation White Paper will all also have an impact. We emphasise the need for consistency across these processes to ensure a coherence of overall approach.
- The Go8 welcomes the government's commitment in the *Tax White Paper* to review the R&D tax incentive scheme in the broader context of reviewing the effectiveness of existing tax incentives for innovation, industry-funded research and collaboration with public research organisations. Ensuring that the tax system stimulates the creation of new high value knowledge-based industries will be critical to diversifying and strengthening Australia's economy. The positive changes to the tax treatment of employee option and share schemes due to commence on 1 July 2015 is also welcomed. The Go8 is currently developing specific and practical policy recommendations to advance the engagement agenda, which we look forward to presenting later in the year.

- Universities are multi-faceted organisations which fuel the Australian economy in a multitude of ways. At its most basic level we train and educate the professionals of the future and explore the world through high quality research. However, focusing on this alone ignores the continual and more complex interactions between our organisations and Australian society. These can include the use of university expertise in the development of public policy or other community benefits; development of specific and targeted courses to address skill gaps in industry or government groups; or the provision of consultancy services around specific issues. It is important that reforms aimed at promoting certain activities do not have the unintended consequence of curtailing other, less visible, benefits.

### **Research and Development (R&D) Tax Incentive**

As noted in our submission to the *Boosting the Commercial Returns from Research* discussion paper, the Go8 represents Australia's leading research-intensive universities, accounting for over two-thirds of Australian university research activity, including about 60% of industry funded contracts.<sup>1</sup>

As such, the Go8 is well positioned to advise on the strengthening of commercialisation and engagement activities, while maintaining the strength and quality of Australia's research industry.

The *Tax Discussion Paper* identifies innovation as a key driver of the economy through productivity enhancements, job creation and improvements in living standards.<sup>2</sup> Research activity is a key driver of innovation, and the high quality of research outputs produced by Australia's publically funded institutions (as reflected by assessment exercises such as ERA and our performance in international ranking systems such as the ARWU and THES) should therefore translate into considerable national advantage.

Yet statistics showing Australia's low rate of industry/researcher collaboration relative to other OECD countries suggests we are not currently maximising this area of national potential. Strategies suggested by the government to address this issue have so far included leveraging university Research Block Grant (RBG) allocation formulae or developing independent engagement metrics that could then be linked to university research funding.

However, such strategies are unlikely to be effective on their own. Successful collaboration requires strong incentives from *both* parties if the barriers to partnership are to be overcome, and loading the drivers too far towards one end of the relationship risks making agreement harder, rather than easier, to negotiate.

R&D tax incentives offer a powerful lever to encourage greater collaboration from industry, and provide an incentive for more firms to actively seek ways to engage in innovation activities. The Go8 believes there are a number of ways these could be reshaped to encourage greater industry innovation engagement, and enhance the effectiveness of other related initiatives such as the Entrepreneurs' Infrastructure Program (EIP) and the Industry Growth Centres (IGCs).

The *Tax White Paper* outlines the current approach to R&D tax incentives:<sup>3</sup>

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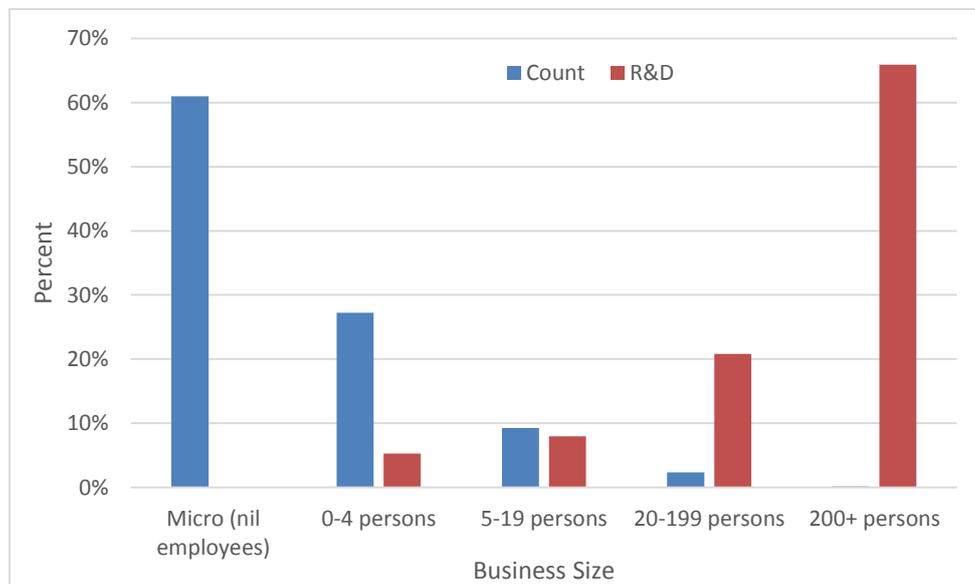
<sup>1</sup> Department of Education and Training, HERDC data collection, 2013

<sup>2</sup> *Tax Discussion Paper*, p. 99

<sup>3</sup> *Tax White Paper*, p. 100.

- A 45% refundable tax offset for eligible entities with an annual aggregated turnover of less than \$20 million, and which are not controlled by income-tax exempt entities, for expenditure on eligible R&D activities in Australia (reduced to 43.5% in the 2014-15 budget); and
- A 40% non-refundable tax offset for all other eligible entities for eligible R&D expenditure (reduced to 38.5% in the 2014-15 budget).

The Australian Bureau of Statistics publishes data showing counts of Australian businesses and amount of R&D activity by size.



**Figure 1: Distribution of Australian Businesses by Size and R&D Expenditure, June 2012.**

Source: Australian Bureau of Statistics.

Figure 1 compares the distribution of business R&D expenditure with that of Australian businesses by size. It shows that the majority of R&D activity is currently occurring in businesses at the larger end of the spectrum, with around 66% of activity accounted for by organisations of 200 or more employees. While this is not unexpected, given the expense of engaging in research and development, it raises a number of issues that need to be considered if tax concessions are to be used as an incentive to maximise industry innovation engagement:

- Larger businesses are important engines of R&D and innovation in Australia. However organisations of 200 or more employees represent less than 1% of Australian businesses; and
- Over 99% of Australian businesses currently account for only around a third of R&D spend. Organisations of 4 or fewer employees represent 88% of businesses, yet undertake only 5% of R&D.

Engaging larger organisations in R&D activity is essential. However, a more nuanced approach, with measures designed to encourage engagement across the business spectrum would help to boost overall engagement, build R&D capacity and help all areas of industry increase productivity and efficiency, regardless of size.

### **Incentives for Larger Organisations (200 employees or more)**

R&D tax concessions aimed at larger organisations need to take into account the cost of conducting such activities onshore compared to competitor countries. A 2014 Deloitte survey of global R&D tax incentives revealed several competitor nations that offer potential deductions of over 100%, including China (150%), India (200%) and Singapore.<sup>4</sup> As noted by PWC, R&D tax incentives in Singapore range “between 100 and 400% – in Australia the equivalent rate is 45%”.<sup>5</sup> Australia’s lack of competitiveness in this context is likely to act as a significant deterrent to large multinational organisations choosing to invest in the considerable research expertise in this country. The government should look at adjustments that could be made to our current taxation system to address this issue.

One option could be to have differential rates of incentive depending on the type of R&D activity. Higher tax concessions or a higher cap could be offered to businesses that engage in partnerships with public research institutions with a strong record of quality outputs, such as universities, especially for projects in disciplines aligned with the Research Priority areas recently endorsed by the Commonwealth Science Council. Such institutions are able to offer considerable advantages to businesses looking to conduct R&D activities they may be reluctant to attempt in-house.

Go8 universities can offer considerable expertise and access to infrastructure, especially for the exploration of nascent ideas that may be too risky for business to invest in alone. Tax incentives designed to encourage this type of activity may help businesses become more willing to pursue increasingly innovative ideas, or even encourage offshore enterprises to invest in the Australian R&D industry. Options should also be explored for leveraging activity generated through the Industry Growth Centre initiative, to maximise the effectiveness of this type of incentive.

Other options might include consideration of variable corporate tax rates. The corporate tax rate in China is usually set at 25%, however companies that are granted High and New Technology Enterprise (HNTE) status (renewable every three years) qualify for a reduced rate of 15%.<sup>6</sup>

### **Recommendations**

- A more nuanced suite of R&D tax incentives to encourage activity across businesses of all sizes
- Differential rates of incentive depending on type of R&D activity, with higher rates for engagement with public research organisations
- Leveraging activity generated through the Industry Growth Centre initiative

<sup>4</sup> Deloitte, 2014 Global Survey of R&D Tax Incentives, <https://www2.deloitte.com/content/dam/Deloitte/global/Documents/Tax/dttl-tax-global-rd-survey-aug-2014.pdf>. Conditions vary across the countries and schemes, according to factors such as type of industry, business size, and type of activity. See Deloitte report for details.

<sup>5</sup> <http://www.digitalinnovation.pwc.com.au/singapore/>

<sup>6</sup> Deloitte, 2014, p.10

Variable corporate tax rates as in China for firms engaging in certain types of activities (eg., High and New Technologies)

### **Incentives for Medium Organisations**

If Australia is to grow its links between public research organisations and industry, incentives need to be aimed at businesses of all sizes. The Go8 supports the broad direction of ensuring that Australia makes the best use of the excellent research that it produces, as discussed in the *Boosting the Commercial Returns* strategy and the recently released Miles Review of CRCs. However it is essential that the drivers put in place to encourage greater engagement produce effective results. Medium enterprises, particularly those at the larger end of the scale, might be interested in exploring innovative practices, but may be reluctant to do so due to perceived risks and expense. This raises the need to create incentives to develop the willingness of Australian businesses to absorb and make use of R&D findings.

For example, an incentive for SMEs to receive a higher level of tax concession (say 60%) for investments in R&D that make use of university intellectual property (IP) could encourage greater engagement at this end of the business spectrum. Such tax incentives could be used to enhance the effectiveness of other programs, such as the grants offered to business through the EIP.

### **Recommendations**

Incentive for medium sized companies to receive higher level of tax concession for investments that make use of university intellectual property

### **Incentives for Smaller Organisations; Entrepreneurship Activities**

A one size fits all model to tax concessions may not be the most effective option, given Australia's industry profile. Consideration needs to be given to SMEs as well as larger businesses if the industry sector is truly to be engaged. Given the large proportion of business that SMEs represent, even a small increase in engagement could potentially result in significant increase in entrepreneurship and innovation activity.

For example, companies are currently "required to have R&D expenditure of at least \$20,000 to be eligible for the R&D tax incentive, which reflects the fact that a certain amount of investment in R&D is necessary to generate significant innovation outcomes".<sup>7</sup> While this might be appropriate to retain for companies above a certain size, ABS statistics suggest that over 60% of businesses are "micro" organisations, run by a single individual. Many such businesses rely on entrepreneurship and innovation, but paradoxically may have the least capacity to engage with research institutions that could help them achieve this goal. Specific, smaller scale incentives could be targeted at very small and micro-businesses (eg., between 0 and 4 employees) to encourage small scale engagement, such as exploring ways for such businesses to engage with research students or early career researchers who can assist them with a specific aspect of their business. Provided such programs are

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<sup>7</sup> *Tax White Paper*, p. 102.

implemented without inhibitive costs they can bring a range of benefits beyond just the immediate impact of improvement to the business, such as helping to encourage greater collaboration, improving innovation, and diversifying the experience of higher degree research students, including making them more ready for and aware of career paths outside academia.

Australia should also consider how it can leverage investments in research infrastructure to help entrepreneurs and start-up businesses. A common barrier to entrepreneurship activities is the so-called 'valley of death' phenomenon, where a new technology or development with potential is unable to bridge the gap from a promising idea to commercialisation.<sup>8</sup> Through programs such as NCRIS (the National Collaborative Research Infrastructure Strategy), Australia has established a suite of research facilities that are potentially able to help small and start-up companies bridge this gap.

The NCRIS-funded Melbourne Centre for Nanofabrication, assisted by the Victorian Government's Technology Development Voucher,<sup>9</sup> has facilitated the development of technologies in the areas of genetic screening and infectious disease diagnostics; chemical oxygen demand sensors (PeCOD®) to provide reliable analysis of water sources; and a technology capable of crushing pressed-pill medications into a palatable liquid.<sup>10</sup> The Go8 recommends the Federal Government investigate the potential for such schemes aimed at small to medium enterprises (eg., less than 200 employees) to help boost innovation and entrepreneurship.

Another possible avenue to boost innovation would be to consider tax concessions for firms that take up new technology. This could prove more attractive to smaller businesses that are less likely to engage in research per se (with all its inherent risks), but might be encouraged to work with universities in the adoption of recent technological developments.

More needs to be done to attract investment into innovation venture funds, addressing the lack of early stage seed investment in Australia. One successful model for tax concessions is the Enterprise Investment Scheme, an initiative of the UK. The initiative offers tax relief to investors purchasing new shares in these companies. A tax reduction of up to 30% of the cost of the shares can be claimed in any one year, up to a total of £300,000. This scheme has seen significant investment and success in start-up companies initiated out of Oxford and Cambridge universities. There is a case for a similar model of tax concessions in Australia.

## Recommendations

No one size fits all model

Targeted small incentives for small to micro size businesses (some 60% of Australian business) unable to outlay \$200,000 on R&D to qualify for incentives currently

Investigate potential for collaborations between small businesses and research students or early career researchers to assist with a specific aspect of the business or business process, and encourage consideration of career paths outside academia

<sup>8</sup> <http://theconversation.com/intergenerational-prosperity-depends-on-supporting-research-38579>

<sup>9</sup> <http://www.business.vic.gov.au/support-for-your-business/grants-and-assistance/innovation-technology-vouchers/technology-development-voucher>

<sup>10</sup> <http://nanomelbourne.com>

Leverage investments in research infrastructure for companies with fewer than 200 employees

Tax concessions for companies that take up new technologies

Tax incentives to encourage investment in innovation venture funds (as in UK)

### **The Not For Profit (NFP) Sector**

The Tax White Paper raises questions about the current treatment of the not for profit (NFP) sector. One of the issues discussed is whether NFP organisations that operate within a market context are receiving an unfair advantage by not being subject to the same tax requirements as general industry.

In recognition of their public good mission, most Australian universities are not-for-profit, income tax exempt and deductible gift recipient organisations. Despite sourcing some revenues through avenues such as student fees, investment income and consultancies and contracts, the higher education sector remains reliant on government assistance for its operations. University financial statements published by the Department of Education and Training indicate that government financial assistance comprised between 42% (commonwealth only) and 44% (combined state and commonwealth) of total revenues from continuing operations in 2013.<sup>11</sup> Any attempt to change the not for profit status is likely to result in a number of adverse consequences, eg:

- A loss of the not for profit status, and subsequent imposition of tax, would effectively impose a significant funding cut on a sector that is already under strain. This would not only reduce the capacity of universities to deliver benefits and services, but would result in pressure being put back onto government to compensate institutions for the effective loss in funding such a move would produce. In addition to inevitable increases in red tape, it is difficult to see how any government would benefit from such an arrangement;
- As not for profit enterprises, universities are not bound to distribute any profits made as shareholder revenue. Instead, these can be invested back into the institution, creating a powerful incentive towards greater efficiencies to maximise the amount of funding available for university operations. If universities were no longer considered not for profit, then this would have the double impact of a loss of funding through the imposition of tax, while potentially diverting profit away from improving institutional operations;
- Deductible gift recipient status provides an important incentive to encourage donations. Though not large in percentage terms, donations and bequests to the sector nevertheless represented a total of \$295 million in 2013.<sup>12</sup>

Despite their NFP status, however, universities are not eligible to claim some Fringe Benefits Tax concessions available to a range of charitable organisations, including some health and research institutes with which universities routinely collaborate. The administrative costs of complying with FBT tax can be out of proportion to the return raised, and puts universities at a relative disadvantage compared to other organisations operating

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<sup>11</sup> 2013 Finance Publication and Tables, <https://education.gov.au/finance-publication>. Commonwealth support comprises Australian Government Grants (includes CGS, Scholarships, ARC grants, etc). State support is provided as "State and Local Government Financial Assistance".

<sup>12</sup> 2013 Finance Publication and Tables, <https://education.gov.au/finance-publication>.

in the same domain. Simplification of compliance costs for FBT could benefit not only universities, but a range of organisations across Australia.

Similarly, there is inconsistent treatment of payroll tax across the NFP sector. Universities are currently subject to this tax requirement while other NFP entities are not. Payroll tax creates a significant imposition that increases the cost of employing staff in a not-for-profit environment, creating a disincentive to employers and a barrier to the government's intention of increasing workforce participation.

#### **Recommendations**

No change to not for profit (NFP) status given significant financial consequences to universities and their students

Consistency within NFP status to redress current inequities of payroll tax and some areas of fringe benefits tax which currently impact universities but do not impact other NFP entities.

#### **Dividend Imputation**

As noted above, universities are heavily reliant on Australian government assistance. However many invest in companies as a way of diversifying income sources and reducing their level of public dependence.

As noted in the *Tax White Paper*, the dividend imputation system is designed to ensure that income is only taxed once.<sup>13</sup> Australian universities are generally income tax-exempt, and those that receive income from shares held in companies are entitled to a refund of imputation credits. Changes to this arrangement would not only be contrary to the stated principle of fairness,<sup>14</sup> it would also act to reduce universities' capacity to access non-government sources of income, thus making the sector even more reliant on government subsidies for their operations. Furthermore, since one Go8 member university uses the revenue received from dividends to fund student scholarships, it may even have the unintended consequence of limiting some students' access to higher education.

#### **Recommendations**

No change to dividend imputation system as to do so would make universities more reliant on government funds

#### **Broadening the GST**

Broadening of the GST Base to include education is likely to have a range of adverse consequences for the higher education sector.

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<sup>13</sup> *Tax White Paper*, 2015, p.73

<sup>14</sup> *Tax White Paper* 2015, p.2

Under the current arrangements, student accommodation is exempt from GST charges, provided the students are charged a rate that is less than 75% of the market value. Securing affordable accommodation is a significant issue for many students, particularly internationals.<sup>15</sup> Education in Australia is already considered expensive,<sup>16</sup> if universities were required to add charges to cover the imposition of a GST it could raise these costs substantially, thus risking the viability of an export industry that currently contributes \$17.5bn to the economy.<sup>17</sup>

Similarly, adding a GST component to the cost of study is likely to act as a disincentive to all students, not just those from overseas, especially if accompanied by a rise in GST rate. Cost increases may also disproportionately impact people from low socio-economic backgrounds, a group with retention rates that are already lower than the general student population.<sup>18</sup> Likewise, reducing or removing the tax deductibility of self-education expenses could pose a considerable deterrent to increasing or improving one's skill base. Any such disincentives would be directly counter to the stated intention of increasing workforce participation and productivity, and is likely to be especially discouraging to mature age workers or mothers seeking a return to the workforce.

#### **Recommendations**

GST should not be broadened to include education sector because of impact on cost of education and effect on international student market, Australia's third largest export market

#### **Summary of Go8 Recommendations**

- Recognition of the importance of R&D tax incentives as a key driver of Australia's economy through innovation and increasing collaboration between the research and business sector, and as an enabler of other government initiatives such as the Entrepreneurs' Infrastructure Program and Industry Growth Centres
- Consider initiatives to boost Australia's international competitiveness as an R&D destination amongst large-scale enterprises, such as differential rates of concession for collaborative activities and/or in the area of the National Research Priorities, or variable corporate tax rates
- Develop initiatives targeted at the micro through to medium scale organisations, such as technology voucher programs, or incentives to engage a PhD student on collaborative innovation activities
- Retain the NFP status of universities, and consider a fairer approach to FBT tax benefits across the NFP sector
- Retain the current Dividend Imputation system
- Retain the education exemption in the GST system

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<sup>15</sup> International student satisfaction ratings with the "accommodation cost" of living in Australia was only 49% in 2014, down from 60% in 2010 (*International Student Survey 2014: Overview Report*, April 2015, Department of Education and Training, p.10).

<sup>16</sup> [www.abc.net.au/news/2014-09-10/australia-most-expensive-place-for-international-students/5735114](http://www.abc.net.au/news/2014-09-10/australia-most-expensive-place-for-international-students/5735114)

<sup>17</sup> <http://www.theaustralian.com.au/higher-education/international-students-add-record-175bn-to-economy/story-e6frgcix-1227337780230>

<sup>18</sup> <http://www.theaustralian.com.au/higher-education/acer-paper-says-uni-dropouts-likelier-to-be-disadvantaged/story-e6frgcix-1227337669632>