Doc 4: 1996 Treasury Incoming Government – Immediate Issues – Taxation Policy

3.4.15 RESEARCH AND DEVELOPMENT TAX CONCESSION

The *Industry and Commerce Policy* statement included a commitment, in respect of R&D, to:

- **maintain the 150 per cent R&D tax concession;**
- **re-examine the impact of proposed changes to the definition of eligible R&D on the operation of the tax concession as an effective incentive for innovation;**
- **introduce cost effective measures to limit the ability of firms already receiving grants for R&D to 'double dip' by also claiming the 150% tax concession; and**
- **re-examine options for a more generally available grant to support R&D in tax loss companies. In the interim, support would be continued on a selective basis through the existing Competitive Grants for R&D program.**

KEY POINTS

- We consider that the whole nature of the R&D tax concession should be examined with a view to removing it from the tax system. There has been a significant increase in the revenue cost of the R&D tax concession, a trend which is likely to continue. The ATO has estimated that the cost of the concession in forgone tax revenue was $630 million in 1994-95 and $525 million in 1993-94 — a rapid growth from $105 million in 1986-87. It is forecast to reach $700 million in 1995-96.
  - The R&D tax concession is one of the most generous concessions provided to Australian industry through the tax system.
  - The concession has been publicly criticised for its cost ineffectiveness — the Bureau of Industry Economics (BIE) has estimated that as much as 90 per cent of R&D investment assisted by the R&D tax concession would have taken place anyway.
  - The measures announced in the Innovation Statement, if developed by this Government, would limit the growth in the revenue cost of the concession only in the shorter term.
- The recently announced amendments to the definition of eligible R&D activities were aimed at improving the clarity and effectiveness of existing legislation.
  - The amendments will do no more than restrict eligible R&D to the type of activities originally intended by the Parliament.
- Measures to limit the ability of firms already receiving grants for R&D to 'double dip' by also claiming the 150 per cent tax concession could remove the need for contamination provisions.
  - The present 'contamination' provisions were recently reviewed in the Industry Commission's (IC) report on Research and Development.

- The IC recommended that the provisions be revised so that companies receiving an automatic or competitive (selective) grant would lose an equivalent value of tax deduction.

  : It was observed by Treasury and the Department of Industry, Science and Technology that to ensure recipients of the tax concession or competitive grants receive an equivalent subsidy would be administratively complex and costly for the ATO to implement.

- The situation of R&D companies in tax loss is currently addressed partly through the grants scheme and partly through allowing R&D syndicates, combining researchers and investors, to access a 100 per cent concession. However, syndication is highly cost ineffective with syndicates being structured primarily to obtain maximum tax benefits from a minimum of genuine new R&D spending.

  - For companies in tax loss undertaking R&D, assistance could be provided through a mechanism which is more transparent and would provide more funds for new R&D with less cost to the Budget.

  - One option is to replace syndication with a generally available grant to companies in tax loss.

ISSUES

Over 90 per cent of syndicates provide a guaranteed return to investors which have no other links with the researcher. Investors need have no genuine interest in or commitment to the outcomes of the research. This results in inadequate commercialisation plans and a lack of access to funds for product development.

REVENUE

The ATO estimate the gain to revenue from the measure to prevent 'double dipping' to be less than $1 million per annum. They assume a 20 August 1996 commencement.

IMPLEMENTATION ISSUES

- The proposal would require amendments to the *Income Tax Assessment Act* and *Industry Research and Development Act*.

- Additional grants to support R&D for companies in tax loss will be well received by those affected.

  - However, if it is coupled with a proposal to remove syndication from the tax system there is likely to be significant criticism.

- Further design work is still required but we envisage that this could be complete in time for the proposal to operate from the 1996-97 Budget.

BACKGROUND

The 150 per cent R&D tax concession was introduced in May 1985, originally as a temporary measure, but was made a permanent feature of the tax system in the 1992-93 Budget. R&D syndication was introduced in November 1987 to allow groups of companies to form syndicates to undertake R&D projects that were beyond the resources of, or considered too risky for, a single company to undertake.

Under current arrangements section 73B of the ITAA contains contamination provisions which do not prevent an R&D project funded by a Commonwealth grant from claiming the R&D tax concession. The provisions only reduce the rate of concessional deduction — usually from 150 per cent to 100 per cent, still greatly accelerated compared to a write off over the life of the R&D results or a write-off over the period of R&D activities.

RECOMMENDATION

We recommend that a Cabinet Submission be drafted to address cost inefficiencies in the current R&D tax concession, including measures to limit the ability of firms already receiving grants for R&D to 'double dip' by also claiming the 150 per cent tax concession, and the possibility of syndication being replaced with a generally available grant to companies in tax loss.

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