AusBiotech
AUSTRALIA'S BIOTECHNOLOGY ORGANISATION

AusBiotech response to the

Business Tax Working Group Discussion Paper

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To: Business Tax Working Group
The Treasury, Langton Crescent
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Introduction

AusBiotech, Australia's biotechnology industry organisation, is concerned at the suggestion that the 40% offset of the newly implemented R&D Tax Incentive be targeted for removal or reduction. While we understand the rationale of the Business Tax Working Group (BTWG) seeking offset savings from within the business tax system or business expenditure programs to fund a cut in the corporate tax rate, AusBiotech is opposed to cutting a program that was initially implemented to support innovation in Australia and to encourage the spill-over benefits that investment in R&D bring to the economy.

AusBiotech is a well-connected network of over 3,000 members in the life sciences, including therapeutics, medical technology (devices and diagnostics), food technology and agricultural, environmental and industrial biotechnology sectors - working on behalf of members for more than 25 years to provide representation and services to promote the global growth of Australian biotechnology.

AusBiotech notes the BTWG consultation has proposed four options to remove or limit the 40% offset of the R&D Tax Incentive to companies with turnover over $20 million. Please find following AusBiotech's comments and concerns.

Too little to justify the damage

To provide some context, the R&D Tax Incentive was the result of many years of work, campaigning and planning that started as far back as its recommendation by Dr Terry Cutler in the Innovation Review (Venturous Australia) of 2008. The innovation industry worked with the Federal Government for almost three years after the Review recommended it, to see the R&D Tax Incentive delivered amid much fanfare as a "landmark reform" by the Labor Government. Together we worked long and hard and the policy represents an important 'legacy' to the economy and to future generations.

Australia can no longer see itself as simply a mine, a factory or a farm. Although they are very important parts of our economy, we need to diversify and support emerging future industries such as biotechnology, which will generate productivity, wealth, jobs for our young people as well as high-tech manufacturing and more. Biotechnology has the capacity to address the big issues of our time, such as food security, alternative fuels, ageing populations, personalised gene-based medicines and diagnostics, climate change, access to clinical trials – and the Federal Government recognised the important role in supporting such innovation with the R&D Tax Incentive.

The sought-after cut in the corporate tax from 30 per cent to 25 per cent would cost $26 billion over the next four years according to Treasury costings. A saving (a cut to a program) of $5.40 billion will approximately equate to the Government being able to fund a 1% company tax cut. The options of concern in the BTWG's discussion paper target the 40% offset of the R&D Tax Incentive and propose four options to save between $0.45 billion and $2.22 billion. Therefore the worst-case scenario of completely cutting out the 40% offset for companies with turnover over $20 million will provide savings to Government to enable the funding of not even a half of 1% company tax cut and a tiny portion of the $26 billion needed to fund the desired 5% company tax cut.

This appears to be nonsensical; it would run counter to the policy intention in the Innovation portfolio, effectively winding back years of work in the critical early implementation of the R&D Tax Incentive policy, jeopardising the spill-over benefits - all to be able to 'move the deck chairs' to an unwanted position. In AusBiotech's view the proposal will take away a vital incentive to conduct research and development, particularly Australia's ability to attract clinical trials, and cost Australians so much more in forgone spill-over benefits. Given there is so little support for innovation in Australia, this change would be a travesty against our future.

Reducing the attractiveness of clinical trials in Australia

Removal of the 40% offset of the R&D Tax Incentive will discourage indigenous and overseas company's from conducting R&D, including clinical trials, in Australia. Nation-wide there are currently 635 trials underway, involving 19,000 Australians, who are given early access to innovative medicines, medical devices and diagnostics through clinical trials. These trials provide a desirable and sought-after spill-over benefit to the community.

One of Australia's two major home-grown medical device companies, ResMed, currently spends over $80 million annually on R&D in Australia. ResMed advises that the removal of the R&D tax incentive would mean the costs of undertaking R&D in Australia would increase significantly for the company, which is already high relative to Europe and the US, given the strength of the Australian Dollar. "It would become more attractive to undertake R&D overseas due to foreign R&D incentives and lower costs of undertaking R&D, resulting in less R&D being undertaken in Australia by ResMed. In other words, ResMed would still undertake R&D but more would be undertaken overseas."

Pete Smith, the CEO of fast-growing Australian biotechnology company Alchemia said changes to the R&D Tax Incentive: "… would significantly reduce our interest in conducting clinical trials in Australia. It would also cause us to rethink maintaining or growing our R&D in Australia as we are currently in the process of listing on NASDAQ and it would make building up R&D more attractive in the US."

Anecdotally, the R&D Tax Incentive for companies with a turnover over $20 million has attracted much attention from overseas companies and many are in the planning process to move clinical trials to Australia – which would have numerous benefits for Australia. John Cullity, Principal, Torreya Partners in New York said: "I can state that, based on my discussions with several US clients, which are in advanced stage discussions regarding bringing their R&D to Australia, this [removing or reducing the R&D Tax Incentive] would represent an entirely retrograde step."

"The over-riding concern of my clients is that this will prove to be a flash-in-the-pan reform, which is here today and gone just as they have set up to run their R&D through the Australian system. What we require are durable, bipartisan reforms which drive the innovation cycle. Reneging on a commitment to the innovation sector would signal that Australian government, quite plainly, does not understand that at all."

The BTWG itself recognises the limitation or denial of the R&D tax Incentive's 40% offset may mean "some companies may relocate their R&D to countries that offer better incentives," placing Australia at a competitive disadvantage.

In June 2012, New Zealand-based Innate Immunotherapeutics announced the company will proceed with plans to conduct a Phase IIB clinical trial in Australia, after positive interim data from the company's Phase I/II clinical trial of MIS416 in patients with chronic progressive multiple sclerosis (MS) and because of the R&D Tax Inventive.

Innate Immunotherapeutics said: "We intend to investigate the sustainability of the improvements in clinical status seen in this study through a 12 month Phase IIB study, which should begin enrolment in early 2013. We now plan to conduct this study in Australia to take advantage of that country's greater patient availability and access to excellent principal investigators and trial sites. In particular, the announcement last year of the Australian Government's R&D tax incentive clenched the country choice for us."

Clinical trials are pivotal to the biotechnology sector in Australia and are estimated to be worth $450 million annually to Australia in investment, spill-over benefits and savings. Australia is in competition with many other countries to secure trials and the Government's Clinical Trials Action Group has been working to ensure Australia's attractiveness, including the provision of the R&D Tax Incentive.

For the first time in four years, the recent 2011 figures from the TGA indicate an increase in the number of new clinical trials in Australia with 635 new trials recorded, up from 574 in 2010, but still down on the 2007 high by 25% (865). The removal or reduction of the 40% offset will reduce Australia's attractiveness for clinical trial and work against policy work being undertaken in innovation, industry and health portfolios.

<u>What will the funds be used for if provided as a tax cut instead of an R&D Tax Incentive?</u>
Discussions with the BTWG during the consultation meeting process indicated that if the proposed cutback was made to the R&D Tax Incentive program and returned to companies as a company tax cut that this would have a neutral (or possibly better) effect. AusBiotech strongly disagrees with this contention. The targeted nature of the R&D Tax Incentive is far more beneficial for encouraging research and development than a non-targeted company tax cut.

ResMed advises: "The removal of the 40% R&D tax incentive would significantly outweigh the benefits of a half of 1% company tax cut for ResMed. This would create a net additional tax cost and therefore does not result in greater investment in R&D or other Australian purposes. However, if the company tax rate was reduced and the R&D tax incentive retained under the current structure, this would actually make R&D more attractive in Australia by increasing the benefit of the R&D tax incentive."

In quantifiable terms "ResMed estimates that based on current R&D expenditure, the removal of R&D tax incentive would cost ResMed $8 million annually, whereas a 0.5% company tax rate cut would merely save ResMed approximately $0.8 million annually."

Cook Medical said: "We, like most companies, view the company tax rate and R&D offset as two different business propositions. The traditional company tax rate has been identified as requiring an adjustment to bring it to a lower, globally competitive level. Any move to eliminate the R&D incentive will be seen as a very clear indicator the government does not encourage the development of new products and processes in Australia."

"Elimination of the R&D offset will affect our future R&D decisions. We will not factor in a company tax rate reduction as a cost saving that could be converted to additional R&D expenditure. We estimate that a 0.5% company tax rate reduction will be less than 50% of the benefit we would lose of the R&D offset is eliminated."

"If the Government wishes to commence looking at the different taxes and tax savings it should start to think about a company's effective tax rate. When the company tax and FBT are combined the effective tax rate of most businesses are already much higher than 30%."

<u>Certainty in the business environment</u>
The negative impact that uncertainty of funding support has on product development/innovation companies is terribly destabilising and the Government's actions in making program changes cause one of the greatest costs, in practical terms. This strikes companies in two ways: firstly companies are not sure whether the measures they have put in place, the deals they have struck and the investments made are going to receive the benefit(s) the Government previously stated would be there; and secondly, those that have not made commitments yet are sure to hesitate and wait for a more stable environment.

The newly implemented tax incentive scheme is the culmination of the Cutler Review and four years later, is still so new, that the claim form have been available for literally two months and most companies are still to lodge their initial claim under the new system. Therefore, there is not yet sufficient data to assess the impact on extra R&D generated or projected costs - and it is certainly too soon to make changes without causing serious uncertainty to innovative companies.

The Tax Incentive is also one of a very small suite of programs to support innovation in Australia, most of which are at current risk of being cut as the Government is looking for savings.

Cook Medical says the tax offset is the only incentive being offered in Australia to conduct R&D activities, and adds that companies need to plan with long-term certainty due to the size of the investment and commitment.

"Removal of the 40% offset, will not only need to be factored into immediate decisions about new R&D projects, but will also be an indicator, that Australia is an unstable environment in which to make longer term commitments about increasing R&D facilities and employing additional researchers," said Cook Medical.

<u>The $20 million threshold</u>

It is also noteworthy that the $20 million turnover threshold that is used as a proxy to differentiate a large company from a small company has been arbitrarily set. The Cutler Review proposed, and AusBiotech agrees, that a higher turnover threshold of $50 million is the target if Australia is serious about encouraging research and development.

There is also a misconception that a $20 million turnover is equivalent to a $20 million profit or that the company is at least wealthy. Breaching the $20 threshold doesn't necessarily mean those companies are actually making a profit. There are a cohort of companies in the $20 - $50 million turnover bracket that represent the borderline where they fluctuate above and below the line are often still in the mode of building an asset (and in tax loss). The notion that companies with a $20 million turnover are no longer in need of support is fallacious and a company tax cut instead of the Tax Incentive would not help those companies.

<u>Conclusion</u>

AusBiotech is opposed to any move that will reduce or limit the R&D Tax Incentive, especially in this early stage of the policy's implementation and will publicly campaign against any such move. The program was initially designed to support innovation in Australia and to encourage the spill-over benefits that investment in R&D brings to the economy. The introduction of the R&D Tax Incentive legislation was a momentous and pivotal inflection point for Australian innovation; the type we as a community will look back on in admiration and congratulate its architects' foresight. AusBiotech urges the BTWG not to recommend any measure that will limit or remove the 40% offset.