Document 1

TREASURY EXECUTIVE MINUTE

Minute No. 20093357

---

4 December 2009

Treasurer

RESEARCH AND DEVELOPMENT (R&D) TAX INCENTIVE — POLICY DECISIONS

Section 22

- While it is not possible to be definitive, on balance the recommended approach should deliver the savings required to ensure that the move to the new scheme is achieved on a budget neutral basis (further details are provided at Attachment A).

Section 22

Contact Officer: Ext:

Acting Manager, Industry Tax Policy Unit

Pages 2 and 3 section 22

Section 22

As with any major reform, stakeholders are concerned about the cost of transitioning to a new scheme. As such, some of the opposition to the recommended approach should be overcome once guidance material is available to assists taxpayers in familiarising themselves with the new scheme.

Section 22

The compliance costs associated with requiring taxpayers to differentiate between their core and supporting R&D will be highest during the early stages of the new scheme but should eventually dissipate as taxpayers adjust their practices. The impact will be much less for R&D focussed firms, such as start-ups.

Section 22

Pages 5, 6 and 7 section 22

Section 22

Taxpayers will be required to differentiate between core and supporting R&D	
16. Taxpayers will be required to differentiate between their core and supporting R&D when registering their R&D activities.	The compliance costs associated with this change will be highest during the early stages of the new scheme but should eventually dissipate as taxpayers adjust their practices.

Section 22

2) FINANCIAL IMPLICATIONS

Key points

- The level of savings required to deliver a budget neutral outcome has increased since the 2009-10 Budget. This is mostly due to a larger than expected increase in claims for the R&D Tax Concession in 2007-08, the level of savings required is now around 12 per cent.
- The data collected through the administration of the current program does not contain the level of detail required to model the impact of different approaches to defining eligible R&D activities.
- The recommended approach is based on sound policy principles and will ensure the new scheme is targeted at activities more likely to achieve a return on taxpayers' investment. While it is not possible to be definitive, on balance the recommended approach should deliver savings of the order required.
- Based on the required level of savings being achieved, the financial implications of moving to the new scheme are estimated to remain broadly revenue neutral over its first four years of operation consistent with the Government's Budget announcement.
  - On an underlying cash basis, when the cost of the interim expansion of the existing R&D Tax Offset[1] is excluded ($65 million in 2010-11), the new scheme has a positive impact of $5 million.
- A financial impact table will not be included in the exposure draft but will be included in the explanatory materials for the final legislation. There will be considerable pressure for the Government to release updated figures on the financial implications of the reforms as part of the exposure draft, particularly among those stakeholders who are opposed to any change in the eligibility criteria.

Budget impact with 12% tightening	2009-10 ($m)	2010-11 ($m)	2011-12 ($m)	2012-13 ($m)	2013-14 ($m)	2014-15 ($m)	Total
Underlying cash balance							
Administered expense	-	-120	-425	-455	-485	-515	-2,000
Administered revenue	-	55	215	490	570	610	1,940
Net impact	-	-65	-210	35	85	95	-60
Fiscal balance							
Administered expense	-120	-425	-455	-485	-515	-545	-2,545
Administered revenue	-	55	215	490	570	610	1,940
Net impact	-120	-370	-240	5	55	65	-605

[1] The interim increase in the expenditure cap for the existing R&D Tax Offset (from $1 million to $2 million) has already been legislated.

Savings required from tighter eligibility criteria

The costings prepared for the 2009-10 Budget assumed a 10 per cent reduction in claims would occur as a result of tightening eligibility criteria under the new R&D tax incentive. That is, after taking into account the gains to revenue from abolishing the existing scheme, and an assumed 10 per cent reduction in claims, the overall package was broadly 'budget neutral'.

Since May 2009, claims data for 2007-08 has become available (the previous costing was based on 2006-07 claims data). Claims for the R&D Tax Concession increased by more than expected in 2007-08, particularly among firms with a turnover of less than $20 million — who receive the most beneficial treatment under the new scheme. As result, a higher level of savings is required to achieve budget neutrality.

Budget neutral – on a cash basis, over the first four years of the new scheme

The 2009-10 Budget states that the move to the new R&D tax incentive and the interim expansion of the existing R&D Tax Offset will have an impact on the fiscal balance of $1,488 million over the forward estimates (2009-10 to 2012-13). This cost is partly offset by a revenue gain of $855 million over the same period. The $633 million shortfall over the forward estimates is because the budget papers report on a fiscal balance basis. The fiscal balance recognises payments under the refundable tax offset a year earlier than on an underlying cash basis. This leads to a mismatch between these payments and the expected savings to revenue.

When considered on an underlying cash basis, the impacts of replacing the old scheme with the new scheme (including the definitional tightening) largely cancel each other out. The policy decisions included in the 2009-10 Budget were taken on an underlying cash basis.

Feedback from stakeholders

Submissions from stakeholders in response to the consultation paper largely focussed on rejecting the need for any tightening of the eligibility criteria,[2] rather than the quantitative impact of different approaches to defining eligible R&D activities. Where stakeholders addressed this issue, views ranged from those who do not expect the changes canvassed in the consultation paper to have any impact to those who consider it would reduce claims substantially.

- In relation to the move from 'or' to 'and' within the definition of core R&D, Ernst and Young stated that the change 'will have a significantly negative impact beyond revenue neutrality'.[3]
- Deloitte surveyed 50 of its clients covering a range of business types. In relation to the move from 'or' to 'and' around 60 per cent indicated that the change would 'significantly'[4] impact on their ability to claim the incentive.
- Michael Johnson Associates argued in its submission that the global financial crisis will lead to a natural reduction in claims under the scheme which combined with the abolition of the current scheme should be sufficient to fund the new R&D tax incentive.[5]

---

[2] Examples include KPMG and PricewaterhouseCoopers.

[3] Ernst and Young Submission, pg 10.

[4] Deloitte Submission, pg 8. The submission indicates that in responding to the question, clients were given a choice of: uncertain of impact; it will have no impact; marginally and significantly.

[5] Michael Johnson Associates Submission, Annexure 2, pg 29.

Pages 11 and 12 section 22