Business Tax Working Group Secretariat
The Treasury
Langton Crescent
PARKES ACT 2600

Dear Secretariat

I am writing to you in my capacity as Chair of the Information Technology (IT) Industry Innovation Council (the Council) to respond to the discussion paper released on 13 August 2012. The Council's membership is drawn from across the IT spectrum and includes representatives of industry, suppliers, users, education, research, government and unions. The Council acts as an advisory body to the Minister for Industry and Innovation, the Hon Greg Combet AM MP both in regard to innovation within the IT sector and information technology's potential to foster innovation across the economy.

The Council recognises the objective of striving for a broad based reduction to the company tax rate is a valid one. However, the Council has grave concerns regarding the suggestion that this reduction be achieved through changes to the Research and Development (R&D) Tax Incentive. The policy objectives of reducing the company tax rate and the objectives of the R&D Tax Incentive are quite different and should not be considered in an either/or scenario.

The Council strongly supports the new R&D Tax Incentive system which came into effect on 1 July 2011 after a long period of review and development involving extensive work and transition costs for both Government and participants. The first claims are being lodged right now. It will take several years for the new system to be bedded down and for the full impacts to be understood.

Importantly, the new R&D Tax Incentive is specifically designed to encourage innovation and business investment in R&D activities by businesses of all sizes. The recently introduced system has been designed having regard to international studies that suggest tax incentives are one of the most successful tools in driving innovative business R&D. An OECD study suggests "tax incentives for R&D are expected to lead to an increase in private investment in R&D, which in turn should lead to an increase in innovation outcomes and ultimately to an increase in long run growth. The policy might also have indirect effects, e.g. on raising wage levels of researchers as more R&D increases demand for their skills, on the (re)allocation of R&D activities and on R&D start-up decisions."[1]

This Council made a significant contribution in the development of the new tax incentive, through submissions to government and direct consultation processes. We believe the incentive is a positive opportunity for Australian companies and particularly for small to medium enterprises (SMEs) as it provides innovative SMEs a tax offset incentive to support their creative R&D activities. The Council is also pleased with the announcement that payments under the incentive will now be made quarterly, further assisting start-up companies at a time when they need it most. Cash flow can be the most important feature of any assistance for small companies in the period prior to their earning revenue. Indeed the R&D Tax Incentive provides assistance for start-up companies in an environment where

1 *The International Experience with R&D Tax Incentives*, Testimony by the Organisation for Economic Cooperation and Development, United States Senate Committee on Finance, September 20, 2011, Tax Reform Options: Incentives for Innovation.

there is market failure in the availability of risk capital and mechanisms such as employee share and options plans are treated unfavourably relative to foreign jurisdictions.

The Council notes the BTWG view that a lower company tax rate will stimulate investment in business, but would make the point that the policy objective of the R&D Tax Incentive is about more than simply attracting investment. The policy objective of the R&D Tax Incentive is fundamentally about developing an innovation-rich business culture that supports sustainable growth based on developing new knowledge and new capabilities. This is particularly important given the competitive, global market place we operate in – to remain relevant Australia must contribute to and participate in the development of relevant innovative new business products, services and processes.

It is also worth noting that the rate of R&D tax support provided by Australia is only mid-range compared to other countries such as Singapore, China, UK, India and the US, already putting us at a disadvantage in terms of our ability to compete globally. Any watering down of current arrangements will undoubtedly exacerbate this further. Furthermore a broad-brush tax reduction at the expense of an explicit R&D program does not expressly support a national R&D agenda – there is in effect, no guarantee that additional investment will be directly committed to R&D to the same scale as is the case under current arrangements. The Council believes that the R&D Tax Incentive is a much more precise tool in facilitating explicit business innovation and R&D activities.

The Council is concerned about any change to the R&D Tax Incentive including the four options outlined in the discussion paper. We note that the savings from all of these proposals would have a minimal impact on lowering the tax rate. Further, we believe the net effect of changing the incentive, would be a shift in benefit from the SMEs who are the cornerstone of innovative activity in Australia, to the large tax paying entities, which ultimately make their R&D decisions on a global basis – potentially leaving innovation in Australia negatively affected.

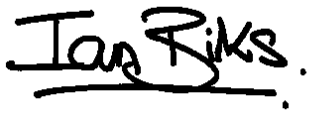
We have further concerns with the assumption in the options provided that SMEs would not be affected as only companies with a turnover greater than $20 million will be captured by the proposed changes. There are a great many innovative SMEs across all sectors, including ICT whose turnover exceeds $20 million. Indeed SMEs can be characterised as having as many as 200 employees with turnover of around $80m - $100m, these, albeit larger and more successful SMEs would therefore be captured by the options proposed by the BTWG. The R&D Tax Incentive is a vital platform to encourage R&D by companies of all sizes. The proposals also run counter to Australian Government initiatives around developing the SME space through Supplier Advocates and other small business programs.

Over the years foreign-owned multinational enterprises have also played a significant role in investing in Australian R&D. According to the Australian Bureau of Statistics, around one-third of total business expenditure on R&D (BERD) in 2009-10 is accounted for by companies with over 50% foreign ownership.[2] Removal or reduction of the 40% non-refundable tax offset would reduce the incentive for foreign-owned companies to invest in Australia's R&D. This is likely to have a negative impact on Australia's overall BERD performance with a consequent adverse impact on innovation and productivity performance of Australian industry.

2 *Research and Experimental Development, Businesses, Australia, 2009-10,* Australian Bureau of Statistics Catalogue No. 8104.0

Australia suffers from ongoing low productivity with many sectors facing transformative pressures. Given the role that R&D and innovation can play in addressing these challenges and the fact that the new R&D Tax Incentive is only now being implemented, we believe that the new R&D Tax Incentive should be retained in its current form and then reviewed after a reasonable period – say three years.

Yours sincerely



Ian Birks
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IT Industry Innovation Council
19 September 2012