UNIVERSITIES AUSTRALIA

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Submission on the Business Tax Working Group Discussion Paper

September 2012

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Summary

Universities Australia welcomes the opportunity to comment on the Business Tax Working Group (BTWG) Discussion Paper released on Monday 13 August 2012. Universities Australia's submission focuses on possible changes to the R&D Tax Incentive outlined by the BTWG.

The Government legislated for the R&D Tax Incentive in September 2011, to apply from 2011-12, part way through the financial year. At the completion of 2011-12, business had had less than a full financial year to plan for, develop and make investments under the new arrangements. Under these circumstances, it is difficult to assess the impact of the options put by the BTWG, other than to note they can only serve to erode the incentive for industry to invest in research and development. They will also adversely affect efforts to boost collaboration between university-based research and industry, an area that holds great potential but needs further encouraged and developed, as noted in the recently released manufacturing industry taskforce report submitted by the non-government members.

At a minimum, the options add to the risk that firms who might otherwise be inclined to invest in R&D, will delay such investment or take the activity offshore.

If the Government is contemplating changes to the R&D Tax Incentive, we suggest the following:

- Allow time for the impact of the R&D Tax Incentive to be implemented and assessed – in line with the Government's stated support for evidence based policy;
- Include in that assessment, modelling of the potential R&D investment stimulated by the existing measure, the potential impact on company finances and government revenue in the medium to long term, and the impacts of change to the R&D Tax Incentive, such as outlined in the BTWG paper, might have; and
- Consideration being given to the signal that such a change will send to the community that a newly introduced R&D tax assistance may be reduced before it has been in operation for more than a single financial year.

A policy shift of this magnitude so soon after the introduction of the revised R&D tax incentive will have a compounding, detrimental impact on Australia's R&D effort at a time of heightened concern about the future of research, development and innovation-oriented program funding.

As the Australian Government has clearly and repeatedly stated, research and development (R&D) is an investment in innovation and productivity and is crucial for Australia's long term prosperity. As such, it deserves ongoing support. If changes are to be made, UA would welcome the opportunity to contribute to a process aimed at increasing and promoting the national benefit of R&D investment.

Introduction

Universities Australia (UA) recognises that reducing business costs will have a positive impact on the Australian economy. Equally, UA appreciates that the Government faces a complex challenge in balancing demands for a cut in the company tax rate, the need to protect the revenue base, meeting necessary expenditure demands, and delivering on important major reforms, such as the Gonski Review of Funding for Schooling. In assessing these competing demands, it is important that the Government delivers clear and consistent messages to business and the broader community about longer-term objectives, priorities and strategy.

The university sector is committed to strengthening its engagement with industry, and contributing to the nation's competitiveness and innovation. A competitive, flourishing and diverse industry sector would be bolstered by stronger university/business partnerships. Australian universities are recognised as being of world class standard[i] [ii], certainly in respect of our core teaching and research functions. The potential to draw on our university-based research capability and work in partnership with industry to build Australia's innovation and productive capability is immense. Australia has the advantage of presenting local and foreign investors with a relatively safe, well regulated and transparent environment[iii], which together with highly developed global research connections, provides an ideal basis for committing funds for research and development. However, despite these conditions, Australia trails the world's leading nations in translating our research capability to industry-based application. Noting the many examples of successful innovation globally that stem from Australian research (health and medical discoveries, GPS, Wi-Fi, Cochlear, Resmed to name a few) we have yet to embed a national culture of development and innovation. Collaboration between industry and higher education institutions has not matured[iv] and requires strengthening.

Background

The Australian Government has substantially increased research funding in recent years, ameliorating the impact of the 22 per cent reduction in Commonwealth research funding that occurred between 1993-4 and 2009. However, Australia lags behind most OECD countries in the rate of private investment in R&D, and reduced its R&D investment in the face of the Global Financial Crisis (GFC), whereas many businesses in OECD countries did not (see Appendix I for further detail).

- Australia ranks in the middle of OECD countries for R&D investment. This is sustained by the Government and Higher Education sector R&D investment, which sits just above the OECD average.
- Business investment in R&D lags the OECD average.
- Nonetheless, over the decade to 2008-09 business R&D investment trended up markedly, from less than half the OECD average in 2000-01, before dipping (more dramatically than the OECD average) after 2008-09 (Refer Appendix I).

It is evident that the Government, in part through university funding, is committed to investing heavily and intensively in research and development. In 2010, R&D expenditure through and by the Higher Education sector reached just over $8.2 billion dollars, representing a more than 20 per cent increase since 2008. The following information hints at the extent of Australia's university-based research effort.

- More than 69,000 academic staff and students were engaged in higher education R&D projects.
- Reflecting the geographic spread of Australian universities, this expenditure and associated research occurred across all States and Territories and covered a vast area of enquiry.
- Almost half (46.8 per cent) of this investment was allocated to research of immediate relevance to industry (ABS 2012).

Universities Australia welcomed the Government's 2009/10 Budget initiatives for science and research, particularly in the Government's ambition to strengthen the links between business and universities in Australia. The Government's White paper on Innovation outlined seven priorities to focus the production, diffusion and application of new knowledge and address Australia's long-term weakness in business innovation and industry collaboration. Priorities three and four aim for a continuing increase in the number of businesses investing in research and development (R&D) and a 25 per cent increase in the proportion of businesses engaging in innovation.

Universities Australia welcomed the subsequent decision to introduce the R&D Tax Credit and then the R&D Tax Incentive. Enacted to apply from July 2011, the R&D Tax Incentive was seen as a positive and prudent policy development that would help redress long-term under-investment in R&D and provide greater assurance to industry that investment in R&D would be encouraged and supported. Universities have actively incorporated the benefits of the R&D Tax Incentive into their engagement and marketing materials for potential collaborative partners[v].

These initiatives reflected major, strategic decisions by Government. While it is too early to quantify the value of these to innovation, productivity, global competitiveness and Australia's revenue base, early indications suggest they are helping to secure much needed private investment in R&D, with Minister Combet reporting that 'business expenditure on research and development hit an historic high of $17.9 billion in 2010/11, an increase of more than 7 per cent from 2009/10'[vi].

A summary of the current R&D Tax Incentive is at Appendix 2.

Discussion

Universities Australia's submission does not respond to all questions posed by the BTWG (outlined on page 7 and page 40), but concentrates on proposals to amend the R&D Tax Incentive (pages 36-38), being to:

- Abolish the 40 per cent non-refundable tax offset (denying the R&D offset to companies with a turnover for the year of greater than $20 million);
- Impose a turnover threshold above which the 40 per cent non-refundable tax offset could not be claimed ($10 billion or $20 billion);
- Impose a cap on the amount that can be claimed annually under the 40 per cent non-refundable tax offset; and
- Cut the rate of the non-refundable tax offset to 37.5 per cent.

Increasing investment and engagement with university researchers is critical to translating discoveries to innovation, broadening our economic base and improving productivity. To achieve this, Government research investment needs to be complemented by a significant boost in private investment and, together with Government programs aimed at engendering greater engagement in research, the structure and stability of Government policy settings will impact directly on the level of investment. The extent to which Australia would benefit from R&D driven innovation, productivity, profitability, industrial diversification, export earnings, revenue, workforce development and prospects is uncertain. Nonetheless, the potential is real and any reduction in the value of the R&D Tax Incentive will further reduce an already poor industry R&D commitment.

In considering possible changes to R&D tax treatment, policy makers must balance the prospects and benefits of a strong R&D sector and the risks associated with private investment levels that remain lower than in nations with which we compete.

The need to build a mature Australian R&D culture was reinforced by the fluctuation and insecurity that marked the fall out of the GFC. A freeze in borrowing on capital markets and an uncertain business future saw significant reductions in investment in research and development across the globe[vii]. However, despite the strong relative performance of the Australian economy during the

downturn, the drop in Australian R&D investment appears to have been much more pronounced than across the OECD at least, suggesting a concerning fragility in Australia's commitment to R&D.

The BTWG's proposals would reduce the availability and value of the R&D Tax Incentive for some firms. While many firms would be unaffected (notably those who make little or no investment in R&D) the adoption of these proposals would strengthen the impression that R&D and the tax incentives that support it are viewed by the Australian Government as being somewhat discretionary and not core to a nation's or business's investment strategy. The proposals have generated considerable negative public reaction[viii]. They have increased uncertainty at a time when Australian industry and higher education institutions need to overcome their history of limited engagement and to develop a culture more in keeping with that of leading innovator nations. Proposed changes to the R&D Tax Incentive, if enacted, will not assist Australia bridge the gap with leading nations.

Universities Australia believes the Australian Government should commit to seeing through the implementation of the R&D Tax Incentive and send a clear signal that investment and collaboration in R&D is a secure and enduring priority.

University-industry R&D partnerships are growing - examples

Murdoch University researchers have recently come up with a potential solution to one of sustainable energy's greatest challenges: power storage for use in non-generation times. Their water-based sodium-ion battery has shown excellent potential for affordable, low-temperature storage. The research has reached the stage (as of September 2012) where they are ready to move beyond the lab towards larger-scale commercialisation[ix].

The University of Queensland is working with Mining companies in Queensland and have developed the JKMetAccount software. This software program was developed jointly with industry personnel over a number of years to enable mine sites to provide better production accounting reporting in line with regulatory requirements[x].

A University of Wollongong invention will help governments around the world measure greenhouse gases following the University's decision to commercialise its greenhouse gas analyser – the Spectronus - in partnership with Australian environmental monitoring solutions manufacturer, Ecotech. The partnership comes at a critical time in Australia with the carbon price arrangements recently coming into effect (as of 1 July 2012)[xi].

The options raised in the Discussion Paper carry a high risk of eroding Australia's efforts to increase business investment in R&D, and the partnerships required to translate research into innovation, productivity and economic growth. These goals feature in a number of the Government's priorities, including the work of the Prime Minister's Manufacturing Taskforce which aims to improve the innovation, productivity and competitiveness of Australia's manufacturing sector, and arguably, the BTWG process itself.

Key Points for consideration

1. Too early for a proper appraisal of the R&D Tax Incentive

The BTWG recognised '*that 2011-12 will be the first year to which the new R&D Tax Incentive applies and there is limited evidence of the effectiveness of the incentive as currently configured*'. Similarly, the BTWG recognised the risks associated with reducing the incentive (and by implication raising the prospect of possible change), noting that some companies may choose to shift their R&D off-shore.

Other reforms, such as the announcement of program details for the Industrial Transformation Research Program, being developed by Minister Evans in consultation with Minister Combet (Hansard 18 September), have yet to be established and changes to the R&D Tax Incentive will affect these details.

2. Effective targeting

Tax-based assistance, such as the R&D Tax Incentive, potentially assists business innovation and investment across the board. It concentrates support in a way that cannot be achieved through some broadly-based measures, such as a reduction in the company tax rate. At the same time, the R&D Tax Incentive sets conditions which support a greater investment in R&D, while avoiding the negative 'distortionary' effects of some elements of the tax system that encourages business to spend in more specific (but not necessarily more productive) areas. The R&D Tax Incentive leaves business free to decide where their investment is most likely to deliver productivity and a competitive edge.

3. Counterproductive to university, industry and government goals

As indicated above, it seems counter-productive to fund a broad reduction in tax burden by reducing the value of measures designed explicitly to encourage development of the factors that feed productivity. The BTWG has identified options that appear to not take account of or align with Government priorities (such as expressed in the initial response to the non-Member report of the Prime Minister's Manufacturing Taskforce and in the development of a Future Workforce and Productivity Strategy). If the aim is to strengthen our economy and create conditions where companies can build capacity, operate profitably and generate the growth that leads to a solid revenue base, offering the prospect of genuine tax relief, some areas that have been identified for "cuts" should be encouraged and broadened. These might include accelerated depreciation, interest relief, and in particular incentives for research and development.

4. Sustaining confidence

The effectiveness of the R&D Tax Incentive (that is, the take up) depends not only on the detailed parameters, but awareness of the measure, developing business confidence to use it and assurance that arrangements will be in place long enough so that the risk of investing is considered worthwhile and manageable. The R&D Tax Incentive has been in place for little over a year in its current form. Making further adjustments will only diminish anticipated benefits.

Universities are committed to working with government and industry to secure Australia's long-term economic future. Practical measures that strengthen industry/research/university collaboration are a priority. The strength of the research and development framework relies on a strong and engaged industry as well as a highly skilled and adaptable university sector. Neither benefits if one is eroded, and without a dynamic partnership, supported by government we face a fractured and muddled future.

Appendix 1

Australia's R&D effort

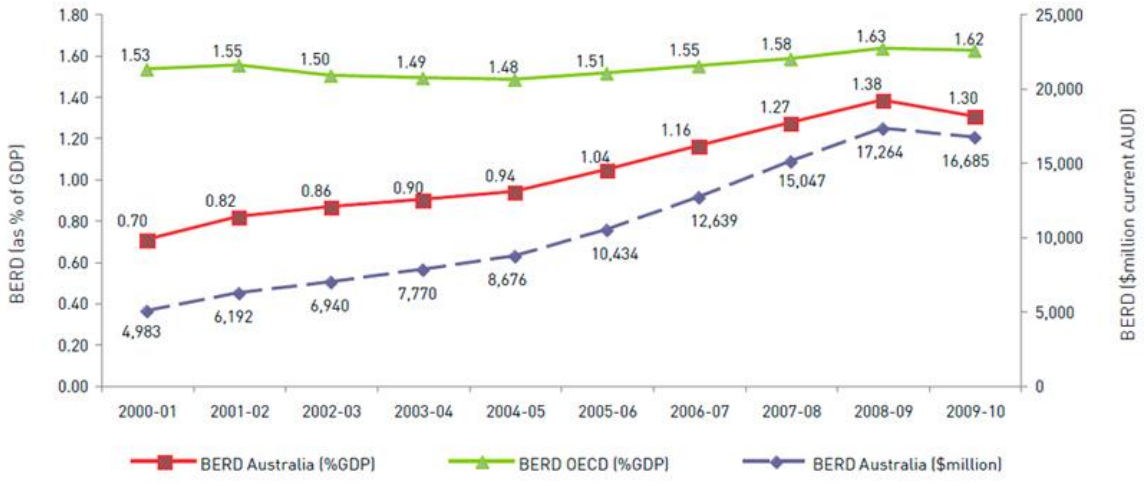
A comparison of the latest available data showing Australia's R&D investment against that of OECD nations is set out in the following table:

R&D Indicator	Reference year	Proportion of GDP Australia (%)	Proportion of GDP OECD average (%)	Australia's OECD ranking
Gross expenditure on R&D (GERD)	2008-09	**2.24**	*2.35*	12th/31
Business expenditure on R&D (BERD)	2009-10	**1.30**	*1.62*	12th/21
Higher education expenditure on R&D (HERD)	2010	**0.59**	*0.50*	8th/26
Government expenditure on R&D (GOVERD)	2008-09	**0.27**	*0.26*	10th/31

Source: http://innovation.gov.au/Innovation/ReportsandStuduies/Pages/AustralianInnovationDataCard.aspx.

Australia ranks among the middle of OECD countries for R&D investment. While Government and the Higher Education sectors invest at just above the OECD average, business investment lags the OECD average. Nonetheless, over the decade to 2008-09 business R&D investment trended up markedly, from less than half the OECD average 2000-01, before dipping after 2008-09, presumably as a result of the GFC. Interestingly, OECD average business investment in R&D did not dip significantly at this point, despite experiencing more severe impacts from the GFC. It is also important to note that investment in R&D among many non-OECD and developing nations has also increased markedly over recent years.

BERD, as a proportion of GDP, Australia and OECD, 2000–01 to 2009–10



Source: MSTI 2011/1 and ABS cat. no. 8104.0, 2009-10.

Appendix 2

The R&D Tax Incentive

The Australian Government provides assistance, through the tax system, to encourage companies to conduct R&D in Australia. The R&D Tax Incentive focuses assistance on R&D activities which are likely to deliver wider benefits.

The R&D Tax Incentive has two elements:

- 45 per cent refundable R&D tax offset - Available to eligible companies with an aggregated turnover of less than $20 million per annum – Refundable for companies (providing a cash refund for companies in tax loss)
- 40 per cent non-refundable R&D tax offset – Available to all other eligible companies – Companies can carry forward unused offset amounts for use in future years

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[i] The Lisbon Council's University Systems Ranking: Citizens and Society in the Age of Knowledge ranked Australia as having the number one university system in the world: http://lisboncouncil.net/publication/publication/38-university-systems-ranking-citizens-and-society-in-the-age-of-knowledge.html

[ii] Australia has the third highest number of universities in the global top 100 in the latest Academic Ranking of World Universities (ARWU) 2012: http://universitiesaustralia.edu.au/page/media-centre/2012-media-releases/australia-increases-the-number-of-top-ranked-universities-/

[iii] World Economic Forum Global Competitiveness report 2010/11, p28: http://www3.weforum.org/docs/WEF_GlobalCompetitivenessReport_2010-11.pdf

[iv] ABS Statistics Table 8110 business investment accounts for 4% of source funds for higher education investment in research and development

[v] Comments made by UA members in response to calls for comments to this Discussion Paper.

[vi] Media release, 11 September 2012: http://minister.innovation.gov.au/gregcombet/MediaReleases/Pages/BusinessRandDspendathistorichigh.aspx

[vii] ABS R&D 81040_2010-11, released 12 September 2012: http://www.abs.gov.au/AUSSTATS/abs@.nsf/Lookup/8104.0Main+Features12010-11?OpenDocument

[viii] http://theconversation.edu.au/academic-warns-against-repeating-randd-tax-incentive-mistakes-8785; http://theconversation.edu.au/scrapping-the-randd-tax-incentive-is-hardly-a-smart-idea-for-economic-policy-8825

[ix] Murdoch university media centre: http://media.murdoch.edu.au/new-salt-based-battery-a-leap-for-green-energy

[x] University of Queensland Research: http://www.uq.edu.au/research/index.html?page=4143; http://www.ventyx.com/

[xi] University of Wollongong research and commercialisation centre: http://www.uow.edu.au/content/groups/public/@web/@raid/documents/doc/uow128788.pdf