



AllA submission on the Draft Treasury Laws Amendment (Research and Development Incentive) Bill 2018

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1.1 About AIIA

The Australian Information Industry Association (AIIA) is the peak national body representing Australia's information technology and communications (ICT) industry. Since establishing 35 years ago, the AIIA has pursued activities aimed to stimulate and grow the ICT industry, to create a favourable business environment for our members and to contribute to the economic imperatives of our nation. *Our goal is to "create a world class information, communications and technology industry delivering productivity, innovation and leadership for Australia"*.

Our membership includes global brands such as Apple, EMC, Google, HP, IBM, Intel, KPMG, Microsoft, Deloitte, and Oracle; international companies including Telstra, Optus; national companies including Data#3, TechnologyOne and Oakton Limited; and many ICT SME's such as Silverstone Edge and Zen Enterprise and start-ups such as OKRDY.

AIIA's Policy Priorities and the R&D Tax Incentive Scheme

The AIIA appreciates the opportunity to comment on the draft Treasury Laws Amendment (Research and Development Incentive) Bill 2018 (the Bill). The Bill is particularly relevant to our policy priority areas of Innovation, Skills and Government Digitisation.

Australia ranks no 22 in the most recent International Innovation Index. AIIA is committed to working with our members and the Australian government to raise our ranking. To this end, AIIA is committed to ensuring that Australia has an internationally competitive R&D tax system that rewards innovation and entrepreneurship of our members.

According to the 2018 Australia's Digital Pulse Report, Australia currently ranks number 12 out of the 16 countries surveyed on business expenditure, on research and development in ICT. However, research and development (R&D) expenditure by Australian businesses in ICT related activities has increased over the past decade and reached \$6.6 billion in FY15/16. This investment needs to be fostered rather than hindered.

It is against this back drop that we note our members' concerns about the proposed Bill. In summary, their concerns are:

- Existing R&D projects will receive less benefits;
- The complexity of the tier based intensity model for Non-Refundable benefits;
- New R&D projects will not occur in Australia with entities relocating its R&D activities to different jurisdictions such as New Zealand, Singapore and Ireland. See appendix A for our comparison of R&D schemes in Australia and key ten trading partners.
- Companies will leave the R&D program which will have negative impact on the R&D culture in Australia, innovation and development of STEM skills for the jobs of the future.

On skills, Australia needs to build capability for a 21st century global economy that is driven by data, digital technologies and innovation. As the government has noted in its four pillars that inform its National Innovation and Science Agenda,

- We have to work together and increase collaboration between industry and researchers to find solutions to real world problems and to create jobs and growth.
- We have to develop and attract world-class talent for the jobs of the future.

Crucially, for a mid-size open economy like Australia, research and development activities must leverage STEM skills in the workforce and increase the capacity of companies to innovate at a faster rate.

If Australia does not have an internationally competitive R&D tax system, companies will move to other jurisdictions where R&D tax schemes are more favourable. This will have flow on effects for

- Innovation in the ICT sector in Australia;
- STEM skills development and application and preparedness for jobs of the future; and
- Australia's ICT exporting capability;

Furthermore, the flow on effects will also impact on the Australian government achieving its targets such as:

- becoming one of the top three countries in the world for Digital Government by 2025; and
- developing emerging and future technologies for the future defence force (Defence Industry Policy Statement 2016)

Our members look forward to an opportunity for further discussions on this proposed Bill.

AllA's Response to the consultation paper questions.

Below is our response to the questions set out in the consultation paper.

1. Do you foresee any implementation and ongoing compliance challenges arising from the proposed calculation of R&D intensity?

Our members believe that the intensity based model does not support a culture of R&D in ICT in Australia.

The reasons for this include but are not limited to:

- a) the complexity of the tiered approach. The complexity of the tiered approach is likely to discourage our members from undertaking R&D activities in Australia and instead move such activities to jurisdictions where R&D schemes are less complex and flat structured, pose less of a compliance challenge and provide greater certainty on eligible refunds;
- b) very few tax paying entities will achieve the level of intensity thresholds being proposed. A 4% threshold benefit for Non-Refundable claimants is insufficient to incentivise investment in R&D. This will have flow on effect on innovation and skills development and the prosperity of Australia more generally.
- c) the tiered approach is not in keeping with R&DTI regime in other countries.

We also endorse the issues that have been raised by Deloitte, a member of AllA, in their submission in relation to the proposed definition of expenditure and compliance challenge.

Recommendation: We recommend the removal of the tiered system for entities with a turnover of over \$20 million in support of a flat R&D benefit rate agreed through consultation between industry, researcher institutions and government.

2. Does the proposed method of calculation of R&D intensity pose any integrity risks?

While the proposed method of calculation of R&D intensity may address some issues that have arisen to date, it will not stop new integrity risks arising despite the extension of the anti-avoidance provisions in Part IVA of the proposed legislation. Entities will try to restructure their affairs to maximise R&D benefit from the proposed method for calculating intensity.

Of additional concern to our members is the shift in government policy from encouraging R&D to focussing on compliance with the scheme. This is not consistent with the policy goals of the proposed legislation to "support additionality in R&D activities and spill over benefits to the broader economy" such as job creation and fostering the ICT business sector and STEM skills.

Recommendation: De-identified data relating to the abuse of the system and mistakes in application to register for the schemes should be made available so that both industry and government can develop a R&D scheme that strikes the right balance between supporting additionality in R&D activities and spill over benefits on the one hand and compliance and fiscal sustainability of the scheme on the other.

3. Could total expenditure be aggregated across a broader economic group? Would this create any implementation and ongoing compliance challenges?

Our members note that aggregating total expenditure across a broader economic group is against the intent of supporting R&D. Furthermore, the inclusion of non R&D entities in the calculating the R&D benefits across a broader economic group will have the effect of reducing the intensity threshold that is able to be achieved.

We have also had the opportunity to review the submission made by Deloitte on this question and we endorse their approach on this issue.

Recommendation: R&D Expenditure should be considered at an individual entity level only.

4. Does the definition of clinical trials for the purpose of the R&DTI appropriately cover activities that may be conducted now and in the future?

Our members have raised concerns about the definition and the preferential treatment being given to clinical trials. Our members are concerned that ICT medical products and devices are excluded from the definition. Such products and devices may also have to go through clinical trials and approval processes for regulatory compliance.

It is also unclear how the government has arrived at its position on providing preferential treatment to clinical trials by exempting such trials from the \$4 million refund cap. By fixing this preferential treatment to clinical trial by legislation, the door is closed to market disruption by other sectors. Legislation takes much longer to amend than policy guidance. Furthermore, the criterion and data to support this preferential treatment has not been made public.

Recommendation:

- a) The definition of clinical trials should include medical products and devices. While the concept of preferential treatment could be embedded in legislation, the criterion should be determined by the ISA Board.
- b) We recommend that the criterion for preferential treatment for certain activities being exempt from the \$4 million refund cap be developed in consultation with the industry and research institutes and reviewed by the ISA Board on a regular basis.
- c) Furthermore, the ISA Board should set up a subcommittee of subject matter experts who are best skilled to develop both the criterion for preferential treatment; undertake regular reviews of the criterion and identify market disruptors that will contribute to the economy through innovation and use of STEM skills.
- d) The criterion should be made available to the public.

5. Does the proposed findings process represent an appropriate means of identifying clinical trials expenditure for the purposes of the \$4 million refund cap?

As per our recommendations above, our members suggest publication of the criterion that needs to be met, including the support documentation that needs to be provided, to qualify for an exemption to the \$4 million refund cap.

Recommendation: The finding process should be extended beyond clinical trials to those activities that meet a published criterion for R&D activities that are exempt from the \$4 million refund cap.

6. Do the draft feedstock and clawback provisions give rise to any unintended consequences that need to be addressed?

Our members have noted that the clawback provisions are very complex in so far as they may apply were an entity is also a grant recipient.

Recommendation: Simplify the clawback provisions and provide clear guidance to explain how clawback provisions will apply when an entity is both a grant recipient for an R&D and also an R&D entity for the purposes of the R&DTII scheme.

Other issues identified by AIIA members

1. Software Development Activities

Data on alleged abuse of the scheme and mistakes made by Software Developers

Efforts to restrict claims for software developments are based on claims that the scheme is plagued by abuse and mistakes by software developers. However, evidence has not been presented that this is a widespread problem. AIIA recommends an evidenced based approach followed by education and support for the software developers community rather than a culture of government policing and auditing.

Recommendation: Existing compliance data be deidentified and made publicly available. Educational material be developed in collaboration with the software developer's community to assist them with compliance with the R&DTI scheme.

The ATO and AusIndustry Guidance Material for Software Development Activities

Our members are currently waiting for the release of the new guidance material on software development activities.

Our members, especially those specialising in software development, are concerned about the following:

- AusIndustry's narrow view of eligibility. For example, earlier guidance acknowledges that testing, implementing and integrating could be registered as eligible core R&D activity. However, now only 'developing' is treated as a core activity.
- software guidance material will be applied retrospectively on R&D entities;
- documentation requirements are confusing. There is no practical guidance from the ATO or AusIndustry in relation to how to meet the support documentation requirements in a commercial context; and
- all activities need to be 'recorded' as R&D at the time they are conducted. Unless the document includes the word 'hypothesis' - like a formal academic R&D exercise, the activity is not accepted. This suggests that research from tertiary institutions have been used as a benchmark for this requirement without reference to industry and start-ups and agile practices. The reality is, companies are different to research institutions and simply do not keep formal academic records of their R&D exercises with a view to publishing articles on their research. For industry, these documents will need to be created specifically for compliance with the scheme and will add to their compliance cost.

Consequences of R&DTI uncertainty on software developers

Our members are starting to look at overseas jurisdiction where the R&D tax incentives are less complex and more generous. The move to relocate R&D activities offshore is proving to be an unintended consequence of the proposed reform and will have both negative impact on innovation, STEM skills development and growth of the ICT businesses in Australia and the Australian government's target of digitising government and having future ready defence force.

Our member case studies provided at Appendix B (not for publication) demonstrate both the benefits that have been obtained to date by the software development sector from the R&D scheme and the intent to move offshore if the R&D conditions are not favourable in Australia.

Recommendation: AusIndustry and ATO engage with both our members and software developer start-ups and vendor communities to develop R&D Guidance material for this sector.

2. Transparency of R&D claimants and expenditure

AIIA members agree that transparency in the R&D incentive tax data is important and recognises the value in data for growing the economy, improving service delivery and transforming policy outcomes for Australia.

Additionally, members support the Australian Government Public Data Policy Statement (2015) that non-sensitive data be released as open data by default to contribute to greater innovation and productivity improvements across all sectors of the Australian economy.

However, the Government's policy statement also notes that it is also important to uphold the highest standards of security and privacy for the individual, national security and commercial confidentiality (our emphasis). The proposal to publish information about R&D activities of R&D entities claiming the R&D offset would involve release of commercial confidential information which would be of value to competitors. Additionally, we are not aware of any other jurisdiction publishing this data.

Recommendation: The publication of Information about R&D activities of R&D entities claiming R&D offset should be delayed by at least 3 years, when the commercial confidential information would be less sensitive.

Proposed Board of ISA delegations and determinations powers

AIIA members are concerned that APS staff may not have the same depth of experience and capability as Board members.

Recommendation: Delegations be limited to administrative tasks such as the approval to grant an extension of time to submit applications, or the ability to request additional information.

3. Collaboration premium should be introduced

Recommendation: Collaboration premium for expenditure with a research organisation should be introduced to foster greater collaboration between industry and research institutes. This would be consistent with the four pillars of the National Innovation and Science Agenda.

4. Consultation Process

AIIA members have noted that public consultation on the proposed changes stopped after October 2016. Twenty months is a long time in the ICT sector. Recent consultations have been both rushed and confined to obtaining feedback on the draft legislation and the six consultation questions.

Recommendation: Consult with industry, associations and research institutes to develop a framework which fosters R&D in Australia within fiscal constraints.

Appendix A

Using data from Deloitte's 2017 survey of Global Investment and Innovation Incentive and EY's 2017 Worldwide R&D Incentive Reference Guide we compare the R&D tax offering of Australia's top 10 two-way trading partners below.

We found that Australia is amongst the least generous when looking at targeted R&D tax incentives. This finding includes specific tax incentives targeted at R&D only. This excludes government R&D grants and other tax offsets such as the patent box and discounted corporate tax rates. If included, the findings would be even worse under the Australian scheme.

Australia is currently behind 8 out of 10 of our top trading partners in terms of maximum assistance available to large businesses and similarly behind 7 out of 10 for maximum assistance available to SMEs.

| Australia | Max assistance available to large businesses | Our rating: large businesses | Max assistance available to SME | Our rating: SMEs |
|-------------------------|--|--|---|---|
| Under proposed reforms | 4%-12.5 % of eligible expenses tied to proportion of R&D expenditure with cap of \$150 million per annum | Australia is behind 8 out of 10 of our top trading partners | 13.5% cash refund of eligible expenses capped at \$4 million per annum | Australia is behind 7 out of 10 of our top trading partners |
| Trading partners | Max assistance available to large businesses | Our rating: large businesses | Max assistance available to SME | Our rating: SMEs |
| China | 12.5% of eligible expenses | On par or behind because of the cap and marginal intensity tiering | 12.5% of eligible expenses | On par even though % of refund is slightly higher because of the cap and marginal intensity tiering |
| Japan | Tax credit of 8%–10% of total R&D expenditure, with a limit of 25% of national corporation tax liability + 30% for special R&D costs + Additional tax credit allowed when current period R&D cost exceeds certain criteria (calculated based on past R&D cost or past annual sales), with limit of 10% of national corporation tax liability | Behind | Tax credit of 12% of total R&D expenditure, with a limit of 25% of national corporation tax liability + 30% for special R&D costs + Additional tax credit allowed when current period R&D cost exceeds certain criteria (calculated based on past R&D cost or past annual sales), with limit of 10% of national corporation tax liability | Behind |



| | | | | |
|--------------------------|---|--|--|--|
| United States | Up to 9.1% of qualified research expenditures | Behind even though % of refund is slightly higher because of the cap and marginal intensity tiering | Up to 9.1% of qualified research expenditures, but certain small businesses can offset AMT and payroll taxes | Ahead or on par because of the cap |
| Republic of Korea | Credit of 3%–40% of qualified research expenses | Behind | Credit of 25%–50% of qualified research expenses | Behind |
| United Kingdom | 8.8% of qualified research expenses | Behind even though % of refund is slightly higher because of the cap and marginal intensity tiering | 33.33% of qualified research expenses | Behind |
| New Zealand | N/A – grants system only but proposing to move to a 12.5% tax credit | If implemented by NZ - Behind even though % of refund is slightly higher because of the cap and marginal intensity tiering | N/A – grants system only but proposing to move to a 12.5% tax credit | If implemented by NZ - Behind even though % of refund is slightly higher because of the cap and marginal intensity tiering |
| India | 30% of qualified research expenses | Behind | 30% of qualified research expenses | Behind |
| Singapore | Multi-tiered super deduction—with the highest tiered rate of 400% | Behind | Multi-tiered super deduction—with the highest tiered rate of 400% | Behind |
| Thailand | Thai corporate entities can take a 100% tax deduction for expenses related to R&D activity + | Behind | Thai corporate entities can take a 100% tax deduction for expenses related to R&D activity + | Behind |

| | | | | |
|----------------|--|-----|--|-----|
| | <p>Thai corporate entities may take an additional 100% tax deduction (a double deduction) for R&D expenses paid to authorised government agencies or private R&D service providers.</p> <p>+</p> <p>a further 100% tax deduction (a triple deduction) for R&D expenses incurred between 1 January 2015 and 31 December 2019, with threshold amounts depending on the gross revenue of the company.</p> | | <p>Thai corporate entities may take an additional 100% tax deduction (a double deduction) for R&D expenses paid to authorised government agencies or private R&D service providers.</p> <p>+</p> <p>a further 100% tax deduction (a triple deduction) for R&D expenses incurred between 1 January 2015 and 31 December 2019, with threshold amounts depending on the gross revenue of the company.</p> | |
| Germany | N/A Grants only. Up to 50% of eligible project costs | N/A | N/A Grants only. Up to 60% of eligible project costs | N/A |