

26 July 2018

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Manager

Small Business Entities & Industry Concessions Unit

The Treasury

Langton Crescent

PARKES ACT 2600

Dear Sir/Madam

Consultation on Research & Development Tax Incentive Amendments

BSI Innovation is a Sydney-based advisory practice that has specialised in assisting companies to access the R&D tax incentives, and other industry grant programs for over 25 years.

We write to provide brief comments regarding aspects of the Exposure Draft and Explanatory Material as our response to the consultation on the Government's 2018-19 Budget Measure - *Better targeting the Research and Development Tax Incentive*.

1. The refundable R&D tax offset for small R&D entities

- 1.1 Permanently reducing the rate of the refundable tax offset to a 'premium' of 13.5% above the prevailing company tax rate from the original 15% differential is a regressive measure which we believe will further undermine new private sector investment in experimental research and development at a time when it is most critical to Australia's future prosperity. We would strongly urge this change not be made, and for the Government to consider setting the rate of refundable R&D tax offset at 15% above the relevant company tax rate.
- 1.2 The proposed recoupling of the R&D Tax Incentive to the prevailing corporate tax rate will particularly impact smaller R&D entities in a tax loss position who are heavily reliant on available cash refunds during their R&D phase. Planned reductions in the company tax rate under the Government's Enterprise Tax Plan reduce the maximum refundable amount available from 43.5% to 41% for the current 2018/19 income year, and to a future low of 38.5% in 2026/27. The negative impacts of this reduction on Australian start-ups and SMEs in a tax loss position due to long-run, capital intensive R&D programs should not be underestimated.

1.3 We note also that a 20% collaboration premium recommended by the 2016 R&D Tax Incentive Review (“the Review”), and reiterated in the recent *Australia 2030: Prosperity through Innovation* report, has not been adopted. We would urge the Government to reconsider this recommendation given the currently proposed changes will, in most cases, lead to a reduction in the final value of the R&D Tax Incentive.

2. Refund cap and exemption for clinical trials

2.1 We do not support an industry or domain specific exemption to an annual R&D tax offset refund cap such as that proposed for clinical trials. A particular strength of the Incentive (and the R&D Tax Concession before it) has been its general availability for eligible R&D activities conducted in almost any industry. It is our view that any annual cap on R&D tax offset refunds should be uniformly applicable to all applicants for the Incentive.

3. Intensity-based R&D tax offset for large R&D entities

3.1 The original 10% and current 8.5% net after-tax benefit (or “Premium”) available for larger R&D entities via the non-refundable tax offset is often a crucial factor for companies in low-margin industries deciding to invest in and conduct experimental R&D in Australia.

3.2 The proposed intensity measures go well beyond the 1-2% threshold recommended by the Review, and mean applicant companies will have to spend 13.125% of their total annual expenditure on eligible R&D activities to maintain the current net after-tax benefit of 8.5%. As reflected in the structure of the Government’s own marginal R&D premiums proposed, this level of intensity is unusual, and highly unlikely to be achieved or sustained by most companies currently accessing this element of the Incentive. The resulting cut to the final value of the Incentive for these firms will likely lead to reduced Australian R&D investment decisions, and the relocation of activities to international jurisdictions with more favourable R&D incentives. Such an outcome would have wide ranging implications for Australia’s economic future, as well as the maintenance of our domestic science and research capabilities.

3.3 Whilst substantially higher levels of R&D intensity can be argued to provide a larger net after-tax benefit than that currently available under the non-refundable R&D tax offset, whether investments in R&D at these levels would occur in the absence of the Incentive has not been specifically addressed in the Explanatory Materials or Consultation Paper, or to any significant extent in the Review itself. Regrettably, and counter to the objectives of the Incentive to encourage new R&D investment that would otherwise not occur, the consequence of these marginal rates of R&D ‘Premium’ will be to offer almost no incentive for those companies with no or very low R&D intensity to actively engage in new or additional R&D efforts in Australia.

4. Transparency of R&D claimants and expenditure

4.1 Whilst we understand the motivations behind the proposal to publish details of claimants of the R&D Tax Incentive each year, we would strongly urge the Government to reconsider the introduction of such a measure.

4.2 In many industries information regarding the quantum of R&D investment by one or more competitors in a given year, and the trend of this investment over successive periods is regarded as highly valuable commercial intelligence. This information, provided to the

Department as commercial in confidence, is not in the public domain for valid reasons. As such, the proposal to publish risks creating a further disincentive for new applicants where proceeding with a claim will result in the publication of information which is commercially sensitive and potentially of significant value to competitors.

4.3 We note further that the proposed publication offers a very limited information set with which a range of public commentators could unfairly critique or criticise individual claimants, despite lacking the full knowledge of the underlying merits of the claim(s) in question, or circumstances specific to a given entity. Again, we would ask that the Government reconsider the introduction of this measure.

Summary

We believe that any change to reduce the net after-tax benefits available via the R&D Tax Incentive in the current economic environment will have significant and immediate negative impacts on the level of business expenditure on R&D, and long-term ramifications for the future prosperity of Australia.

The proposed changes to the program represent a significant reduction in available benefits for most applicant entities, as well as increased complexity and compliance costs in preparing claims. Whilst we understand and support the need to ensure program integrity, there are a range of alternative legislative and administrative mechanisms which could be utilised to achieve the desired compliance and integrity outcomes, while better aligning to the objectives of the Incentive and maintaining it as a key driver in the decision to invest in experimental R&D in Australia.

We would be happy to provide further expansion on any of the points noted above, or attend a meeting with Treasury officials as appropriate. If you have any questions regarding our submission, please contact us on (02) 9126 9100.

Yours sincerely
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