

26 July 2018

Manager
Small Business Entities & Industry Concessions Unit
The Treasury
Langton Crescent
PARKES ACT 2600

Dear Sir/Madam,

Chemistry Australia – R&D Tax Incentive Amendments – Exposure Draft Consultation

1. Chemistry Australia welcomes the opportunity to provide this submission to the consultation on the exposure draft of the *Treasury Laws Amendment (Research and Development Incentive) Bill* (Exposure Draft).
2. Chemistry Australia (formerly the Plastics and Chemical Industry Association) is the peak national body representing the chemistry industry. Chemistry Australia members include chemicals manufacturers, importers and distributors, logistics and supply chain partners, raw material suppliers, plastics fabricators and compounders, recyclers, service providers to the sector and the chemistry and chemical engineering schools of leading Australian universities.
3. The chemistry industry is the second largest manufacturing sector in Australia. Our industry employs more than 64,000 people, with every job creating five more in related supply chains. The industry contributes \$11.6 billion to gross domestic product, and supplies inputs to 109 of Australia's 111 industries.
4. Chemistry Australia and its members have a long history of collaboration with the CSIRO, Australian universities and the research community. To illustrate, the inaugural intake under the Chemicals and Plastics Manufacturing Innovation Network (CAPMIN) program co-ordinated by Chemistry Australia and Monash University has placed 17 Ph.D. candidates within chemical manufacturing businesses across Australia, providing an opportunity for those candidates to complete their studies undertaking R&D that delivers innovation in a commercial environment. A second round of 16 Ph.D. candidate placements under the CAPMIN program is about to commence.
5. The Australian chemistry sector is a significant investor in Australian R&D, spending \$760 million in 2015/16. Just over 60% of this spend was by companies with more than 200 employees.
6. Australia's chemistry sector, like many other Australian industry sectors, is typified by businesses requiring large capital investment; having large input and running costs; and operating on very tight margins.
7. The current consultation is focused on integrity related aspects of the Bill that is intended to give effect to the changes announced by the Government in the Budget. Those changes, particularly the introduction of intensity thresholds, are intended to reduce the cost of the R&D tax incentive to the Budget; **more than halving the value of the tax incentive to most of its current recipients.**
8. **This reduction of the R&D tax incentive will result in a reduction of R&D activity undertaken in Australia.**

9. Indeed, feedback from Chemistry Australia members – be they, Australian headquartered multi-national enterprises or Australian subsidiaries of overseas businesses – indicates that the Budget changes are already factoring into decisions about where they locate R&D activities. Australian based R&D activities will be reduced and shifted to locations that offer a better return on R&D investment.
10. SME members have described the changes to the R&D tax incentive as “disastrous”, reducing their capacity to invest in R&D that enables them to innovate and compete in both domestic and export markets.
11. The introduction of an intensity threshold as set out in the Exposure Draft and related consultation questions have several other consequences:
 - a. The recent and rapid increase in energy cost are likely to increase expenditure and therefore reduce the levels of R&D expenditure intensity. Businesses already struggling with high energy costs will be additionally penalised.
 - b. Expenditure, and therefore, the level of R&D intensity and the value of the R&D tax incentive can only be determined when the tax return is prepared and lodged, many months after the end of a financial year. Unexpected expenditure during a financial year may reduce the level of intensity and result in the loss of tax incentive. This creates a level of uncertainty around the value of the tax incentive, making R&D expenditure in Australia less attractive - businesses will prefer locations that provide certainty.
 - c. The proposed intensity calculation method combines tax and accounting concepts that will be challenging for companies to apply and the ATO to regulate. This will likely result in additional compliance challenges and increased costs for companies.
 - d. Grouping beyond tax consolidated groups (per consultation question 3) should be avoided. Any grouping based on a measure of economic control will provide a disincentive for large businesses to invest or provide capital in complementary start-up businesses, where they may not need to take 100% ownership. It will dilute the business cases of R&D joint ventures, for example between industry and Australian research institutions. Expanding aggregation to an economic group will also create compliance uncertainty in identification and tracing of ‘controlled’ or affiliated entities.

Application of the intensity threshold at a consolidated group basis will also dilute the claim for dedicated research labs or divisions within a larger group, again increasing costs to the point where many may become uneconomic. We urge Treasury to consider quarantining dedicated R&D divisions or subsidiaries from the intensity threshold, even if on a grandfathered or application basis.
 - e. The changes to feedstock and clawback provisions merely serve to add further layers of significant complexity in terms of compliance which, of themselves, add no tax benefit.
12. In terms of the Exposure Draft, Chemistry Australia recommends that to provide a better reflection of the ability of a business to spend on Australian R&D, the definition of an entity’s total expenditure should not include:
 - a. The Cost of Goods Sold; or
 - b. Costs related to any business run as an overseas branch of the Australian entity.
13. Excluding the Cost of Goods Sold from the intensity calculation would remove some of the disadvantage faced by manufacturers and distributors vis-a-vis enterprises that generate their income from large capital assets or from services.

14. Finally, the continued tinkering with the R&D Tax Incentive over recent years has increased the risk of committing to R&D investment in Australia. This risk, combined with the uncertainty surrounding the value of the tax incentive, run counter to the Government's aims of encouraging R&D activities in Australia, they increase compliance costs for business and do little to attract, retain and provide increased opportunities for STEM professionals.
15. If you would like to discuss aspects of this submission, please don't hesitate to contact me on 03 9611 5411 or by email at blee@chemistryaustralia.org.au.

Yours faithfully



Bernard Lee
Director - Policy and Regulation
Chemistry Australia