



26 July 2018

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

Email: RnDamendments@treasury.gov.au

Dear Sir/Madam

Research and Development Incentive Bill 2018

The Corporate Tax Association (CTA) welcomes the opportunity to comment on the Treasury Consultation Paper, Exposure Draft and Explanatory Materials in relation to the Treasury Laws Amendment (Research and Development Incentive) Bill 2018 (the Draft).

The CTA's membership consists of 124 of the largest corporations in Australia with approximately 75% listed on the Australian stock exchange. CTA members cover all industry sectors which between them account for approximately 54% of all corporate income tax collections for businesses covered by the ATO's public tax transparency disclosures at around \$21 billion. A list of members can be found on our website at <http://corptax.com.au/member-companies/>.

Our comments below focus on the non-refundable tax offset intensity threshold and the transparency measure.

The CTA is extremely disappointed with the policy change to the incentive

Whilst the CTA is fully cognisant of the cost increases to the budget bottom line of the incentive in the past, we are firmly of the view that the design of the proposed intensity test is not the way to deal with budgetary cost pressures which are driven predominantly by increased revenue costs and integrity concerns in the refundable offset space.

In our view, issues around the integrity of the system should be addressed by introducing the proposed changes to Part IVA and providing additional compliance and advisory resources for Innovation and Science Australia and the ATO, rather than radically reducing the R&D incentive for those taxpayers who are compliant with the spirit and intent of the current incentive. Whilst affordability and incentivisation is always going to be a question of balance, the proposed changes to the incentive for large corporates tips the scales too far to the former and do not consider the medium and longer term impacts to the wider Australian economy of reducing the incentive.

In our view, the proposed R&D changes need to be placed in the context of Australia's overall corporate tax policy framework, including the impact of imputation. Given Australia's high corporate tax rate for large taxpayers (currently 30%, and potentially not reducing to 25% until 2026/27), the proposed changes are sending a very strong message that Australia is not open for business, and is not seeking to attract incremental R&D investment for the vast majority of large corporate groups.

Whilst we fully appreciate the policy driver behind the R&D incentive is based off encouraging additionality and spill over benefits, a 4% effective tax benefit for eligible R&D expenditure for all but a handful of large taxpayers is more than a 50% reduction in the incentive, even with the introduction of the \$150 million expenditure threshold. Such an outcome is sending a very clear message that Australia does not want incremental R&D activity or any potential future investment and jobs this may drive to be undertaken in Australia by corporates with turnover as small as \$20 million. Whilst the proposal in the draft law is a marginally better outcome for larger corporates than that proposed in the initial *2016 Review of the R&D Incentive* report, at a practical level, many CTA members have indicated the proposed changes will not drive incremental R&D activity and in fact it may do the opposite.

In our view, to argue that the R&D incentive should not operate to give a tax incentive to "business as usual" activities is curious. At one level, as R&D activity is "business as usual" for a company solely undertaking R&D, a "business as usual" view of the operation of the incentive would mean such companies should not get any benefit at all. However, the main beneficiaries under the proposed changes are such companies, not those who undertake incremental R&D (or accelerate existing R&D activity) where they have high levels of current expenditure related to running their "usual" business.

The definition of expenditure needs refining

The current proposal is for R&D intensity to be calculated by reference to eligible R&D expenditure as a proportion of total expenditure. Total expenditure references accounting standards which appears to include capital and revenue costs (presumably only incurred in Australia). The term expenditure would also appear to cover:

- Outlays for items such as GST, excise and income taxes.
- Expenditure that is referable to the production of goods and services (cost of goods sold) that are sold locally and/or exported.
- Expenditure that is incurred in Australia (such as head office costs) but recharged by an Australian headquartered multinational to their offshore affiliates.
- Expenditure also would not appear to include non-cash items such as:
 - book or tax depreciation; or

- unrealised losses on investments and/or unrealised foreign exchange losses.

In our view, to ensure the numerator and denominator in the intensity test are consistent, (and more importantly, do not by their workings discriminate against Australian companies that have decided to maintain manufacturing or service-based activity in Australia) the total expenditure definition should be recast and reference an "Australian linked tax expense" (not expenditure) concept.

An Australian linked tax expense definition could be designed by reference to Australian tax-deductible expenses (which would include tax depreciation), excluding that proportion of tax deductible costs that are referable to the production of goods or the provision of services undertaken in Australia that are exported. For example, if Company X had total expenses incurred in Australia of \$100 and 10% of such expenses relate to the production of goods for export and 10% for head office costs charged to offshore affiliates as a service, the denominator in the intensity threshold should be \$80, not \$100.

Expenditure should reference prior year(s) and not current year expenditure

A design feature of the R&D system is early registration of eligible claims and the planning of R&D activity well in advance of undertaking the activity. This will, in many cases, require knowledge of the estimated amount of R&D incentive that may be claimable before the claim is lodged. A current year expenditure denominator is susceptible to changes that are beyond a company's control such as interest rates, foreign exchange rates or input prices (such as commodity prices). This makes planning R&D activity and registration problematic.

In our view, alternatives to current year expenditure should be considered, such as the previous years' expenditure, or an average of several previous years, to provide claimants with the certainty needed to plan R&D activity. Prior year expenditure could be increased by an inflation factor if it was felt necessary to have the numerator and denominator on a like-for-like basis. This would also minimise the cost of compliance given such expenditure figures are known (and audited) and gathered from tax returns that have been lodged. We note that any integrity concerns related to taxpayers "gaming" expenditure year on year is highly unlikely in the context of large public groups and if detected could be dealt with under the proposed changes to the general anti-avoidance rules. Indexation of costs would also help in this regard.

Tax transparency

The draft legislation contains measures to make public the name of the R&D tax incentive claimant in addition to its ABN and R&D notional deductions, regardless of company size. Notional deductions are of course not the sole determinant of the size of a refundable or non-refundable R&D offset claim. R&D notional deductions represent the amount from which the tax offset is calculated, not the tax benefit received. It is also worth noting that R&D expenditure is generally fully deductible for company income tax purposes, so the benefit (as is shown in the

recoupment rules proposed) is in fact the tax offset amount above the corporate tax entities' underlying tax rate.

In our view, without having knowledge of an entity's turnover, it is not possible for the community to understand the size of individual R&D tax offset claims, nor in fact, the total cost to the community of the scheme.

We would recommend that any publication of R&D data should only reflect the tax benefit for each company above that entity's underlying corporate tax rate and not the notional deduction amount. This will provide more meaningful data for the community and should equally address the integrity aspects behind the introduction of the measure.

We also note that the publication of the notional deduction figure may also raise commercial confidentiality issues, particularly for smaller companies with low (or no) turnover. Indicating the size of the R&D offset above the underlining corporate tax rate rather than the notional deduction would provide additional safeguards around such commercially sensitive information and can be easily captured from tax returns that have been lodged.

Should you wish to discuss any aspect of this submission in further detail, please do not hesitate to contact myself or Paul Supree of this office.

A handwritten signature in black ink, appearing to read 'Michelle de Niese', with a flourish extending to the right.

Michelle de Niese
Executive Director