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26th July, 2018

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

Email: RnDamendments@treasury.gov.au

Dear Sir/Madam,

Re: Draft Treasury Laws Amendment (Research and Development Incentive) Bill 2018

Thank-you for the opportunity to provide feedback on the 2018/19 Budget Measure: "Better targeting of research and development tax incentive."

Manufacturing Australia (MA) is led by the Chief Executive Officers of Australia's largest, locally-headquartered, manufacturing companies: Adelaide Brighton, BlueScope, Brickworks, Capral, Cement Australia, CSR, DuluxGroup, Incitec Pivot, Orora, Rheem and Tomago Aluminium. MA member companies employ around 50,000 people directly, and operate some 300 plants or smaller facilities, predominantly in outer suburban and regional communities, around Australia.

MA's member companies are amongst Australia's largest R&D investors, with numerous projects run both in-house and in partnership with universities. Notably, MA members have a strong track record for commercialisation and practical application of R&D projects resulting in new investment in manufacturing and jobs.

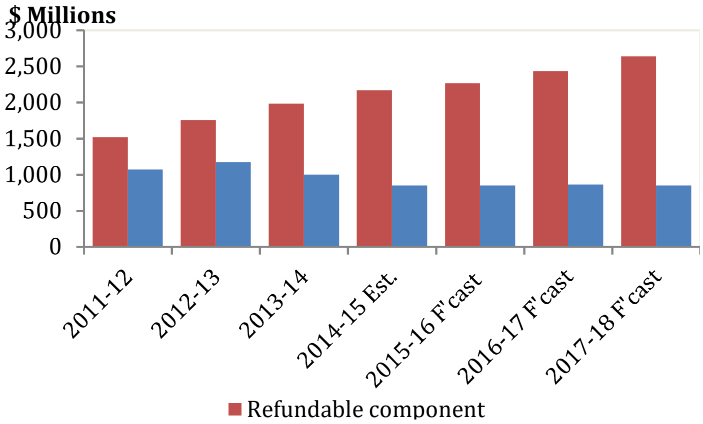
MA recognises the need to manage the costs to government associated with the R&D Tax Incentive. However, MA has persistently argued in submissions and public commentary that the proposed "intensity" methodology for refundable R&D tax incentive claims is inequitable and disadvantages domestic manufacturers against import competition.

Manufacturing Australia's position:

1. Manufacturing Australia **supports the integrity measures** as proposed in the budget.

2. Manufacturing Australia also **supports the cap on cash refunds**. Figure 3.3 below, from the 2016 R&D Tax Incentives Review, shows that the cost growth from the R&D Tax Incentives scheme has been overwhelmingly from the refundable component. It makes sense, therefore, that this area should be the focus of cost reductions.

Figure 3.3: Programme cost by component (2011-12 to 2017-18)



Source: Department of Industry, Innovation and Science estimates using data from the 2015-16 MYEFO and 2015 Tax Expenditure Statements.

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3. However, Manufacturing Australia is **opposed to the proposed intensity model** for the refundable component. It unfairly disadvantages domestic manufacturers that have a large operating cost base, and gives competitive advantage to competitors that import finished products manufactured overseas.

Explanation:

- Measuring R&D "intensity" as a proportion of total operating costs is an inequitable model that provides different R&D incentives for different manufacturing companies, effectively disadvantaging the company that chooses to keep manufacturing in Australia, while advantaging companies that import.
- Australian manufacturers that undertake R&D alongside local production typically have high production costs comprising raw materials, labour, energy and other inputs.
- Because of this, most large Australian manufacturers – even those with very good R&D track records – do not spend more than 2-5% of total costs on R&D.

Impact:

- Under the proposed "tiers" most large Australian manufacturers will see their incentive reduced from 8.5% to 4%.
- Meanwhile, competitors that undertake R&D in Australia but have little or no local production could realistically expect their incentive to increase from 8.5% to either 9% or 12.5%.
- The intensity measure combined with the $150 million total claim limit prohibits any company with a cost base over $1.15bn from ever regaining the previous 8.5% incentive, regardless of its R&D "intensity."

Recommendation:

- Manufacturing Australia recognises the need to reduce government expenditure on the R&D tax incentives scheme, but changes to the scheme should be equitable and treat two companies undertaking the same R&D equally.
- In particular, Manufacturing Australia recommends:
    1. Proceeding with the integrity measures as proposed in the budget
    2. Proceeding with the cap on cash refunds as proposed in the budget
    3. Reducing the base rate of R&D tax incentive for all companies from the current 8.5% to 6.5%; and,
    4. Retaining the higher tiered incentives for those companies that increase their R&D intensity compared with previous years. In this way, the scheme would encourage continuous improvement and increased R&D expenditure, effectively seeing companies "compete against themselves", without creating an unfair disadvantage for companies with large domestic operating costs.

Should you wish to discuss any part of this submission, please don't hesitate to contact me.

Yours sincerely,

Ben Eade
Executive Director
Manufacturing Australia