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To whom it may concern

Response to the R&D Tax Incentive Consultation
Draft Treasury Laws Amendment (Research and Development Incentive) Bill 2018 and Explanatory Materials

ShineWing Australia thanks you for the opportunity to provide feedback to the draft Treasury Laws Amendment (Research and Development Incentive) Bill 2018 (Draft R&D Bill) and Explanatory Materials (EM).

Overall, we understand the Government's plan to better target the R&D Tax Incentive and improve its integrity and fiscal affordability. However, it is our opinion that the mechanisms through which such changes are sought, are likely to be detrimental to Australian business, and more specifically, detrimental to business expenditure on R&D (BERD). While we broadly support the Government's goals to deliver a sustainable R&D Tax Incentive program that incentivises 'additionality', we are concerned about the impact of these changes.

To provide context for our response, we have outlined the following in the below paragraphs:

1. Background to ShineWing Australia and its connection with innovative businesses
2. Historical impact of R&D program changes on BERD
3. Mismatch between ISA2030 Strategic Plan & 2016 FFF Review findings and the proposed R&D changes
4. Response to specific consultation questions including recommendations
5. Conclusion.

We thank you in advance for your consideration of our response. We welcome the opportunity to discuss this further with you and look forward to stable and consistent R&D policy moving forward.

Yours faithfully

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1. Background to ShineWing Australia and its connection with innovative businesses

ShineWing Australia is an Australian owned advisory and accounting firm with an 80 year history that chose to take the lead in Asia Pacific by joining the ShineWing International network. In Australia, we are based in Melbourne, Sydney and Brisbane and have 35+ partners and 250 staff.

Since 2005, there has been approximately $91b invested from China into Australia and ShineWing's clients have invested $59b of this (almost two thirds). Some of this investment was made considering our tax policy, including R&D Tax Incentives. Start-up businesses in life sciences and robotics sectors are recent examples of those currently looking at locations to conduct their R&D world-wide, with the R&D Tax Incentive previously being a large draw-card for Australia. However, recent feedback, especially around consistent policy changes and uncertainty in the continuity of the R&D Tax Incentive program moving forward, has meant these businesses are unsure about investing in Australia.

ShineWing Australia has dedicated teams to assist innovative businesses through all stages of growth from start-up businesses through to large multinationals. We see firsthand the impact government funding, including the R&D Tax Incentive, has on job creation, business sustainability and profitability, and productivity.

Almost all of our clients will be worse off under the proposed R&D changes with many businesses exploring different options, including off-shoring their R&D in light of these changes. Our clients are concerned about continual changes to the R&D Tax Incentive program and want consistent and stable policy to make investment decisions.

2. Historical impact of R&D program changes on BERD

The R&D Tax Incentive (along with the former R&D Tax Concession) has had strong bipartisan support for over 30 years. The program is the Government's principal method of investing in business innovation and consequently has been a strong, consistent driver of additional R&D spending by businesses.

Indeed, we note that positive changes to the R&D programs since 1985 have resulted in increased BERD, as a proportion of GDP. In contrast, negative changes have had damaging impacts on BERD.

Specifically, BERD as a proportion of GDP was at 0.39% prior to the introduction of the former R&D Tax Concession program in 1985. By 1995, this lifted to 0.85%. In 1996, there was a tightening of the former R&D Tax Concession program and by 2000, BERD was at 0.71% of GDP. Interestingly, in 2001, support under the former R&D Tax Concession program lifted and in 2005, BERD was at 1.05% of GDP. Until 2009, there was a sustained growth in BERD as a proportion of GDP, when the Government announced further changes to the R&D program and ever since the BERD as a proportion of GDP has dropped. This is likely because of the continual changes to the R&D Tax programs (both Concession and Incentive).

A 2016 paper on R&D additionality in Australia from Swinburne University of Technology highlights that an "*average R&D active firm which claims an R&D tax subsidy invests statistically significantly more in R&D than a 'similar' R&D active firm which does not claim a tax subsidy."* This suggested correlation shows that Australian R&D subsidies (specifically the Concession and Incentive programs) lead to increased R&D expenditure and it's clear that the converse is also true.

In short, from historical evidence, it is likely that changes proposed in the draft law will negatively impact BERD. Additionally, the on-going changes and broader program uncertainty also appear to be damaging.

Recommendation: We strongly recommend that no further changes are made, so as to restore confidence and stability in the program. This should assist in lifting BERD after the likely continued decline over the next couple of years, due to these changes.

3. Mismatch between ISA2030 Strategic Plan & 2016 FFF Review findings and the proposed R&D changes

While we note that many changes recommended in both the 2016 Finkel, Ferris, Fraser review of the R&D Tax Incentive (FFF review) and the Innovation and Science Australia 2030 Strategic Plan (ISA2030), there were positive recommendations not enacted. Specifically:

- Collaboration premium – The recommendation in both reports suggested an 'up-lifted' R&D benefit for expenditure incurred with public research institutions. Given ShineWing Australia acts for 35 of the top education institutions (i.e. universities) in Australia, we were disappointed to see that this was not enacted. We note the Group of Eight Universities (Go8) submission to the FFF review stating that *"The Go8 is definitive in its position that the collaboration premium is a critical element of fostering… [collaborative innovation]"*. Public sector research collaboration should be a key focus of government investment in R&D. We trust this will be reconsidered.
- No additional direct funding – We were again disappointed to see that the $2.4b in planned savings over the forward estimates was not redirected into other innovation initiatives. This was a recommendation of the FFF review which was again not considered. As a consequence, we are concerned about the long term impact on BERD and more broadly, productivity and economic growth.

Additionally, we note that neither the FFF review nor the ISA2030 considered a 4% net benefit for companies with an aggregated turnover of more than $20m. We understand this will be the lowest R&D tax benefit on offer globally. At this rate, there are few companies that will be able to claim, given the compliance costs.

Recommendation: Re-consider the collaboration premium and re-directing the cost saving measures to direct grant funding programs for business innovation. Increase the lowest net benefit rate for companies with over $20m aggregated turnover, such that they will be incentivised to conduct additional R&D.

4. Response to specific consultation questions including recommendations

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

- The R&D intensity measure will not allow a company to accurately budget their R&D benefits into their planning, as the benefit will only be able to be determined after the year end.
- Using accounting standards to determine 'expenditure' may have unintended consequences. Specifically, accounting standards are potentially less strict compared with taxation laws. As one example, accounting standards do not require expenditure to be at 'arm's length'. Additionally, accounting standards require matching of expenses or expenditures, rather than the taxation concept of 'incurred'. Finally, it is unclear if 'expenditure' would include capital expenditure such that both notional deductions for R&D decline in value of certain assets would also be included, in addition to the full up-front capital cost of an asset, for 'expenditure' purposes. This becomes complicated.
- The R&D intensity measure unfairly targets certain high-cost, low profit-margin industry sectors such as manufacturing (the current biggest contributor to BERD), agri-business and energy and resources among many others. Excluding expenditure from cost of goods sold may provide a fairer calculation.

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

- Given Part IVA and the proposed enhanced R&D specific integrity measures, we trust that companies, and tax agents alike, will appropriately conduct their affairs, claiming legitimate entitlements.

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

- It will be sufficiently complex to determine expenditure on an entity basis but to consider broader entities would be, at times, near impossible. The definition of 'R&D entity' already includes tax consolidated groups. Outside of this, many companies in broader economic groups operate completely independently and are not allowed to access financial information from other grouped entities. Compiling this information would be too onerous and will mean that many entities in larger groups will no longer claim. This may lead to substantial long-term detrimental effects on BERD.

Recommendation: If an R&D intensity measure is required, we recommend the following:

- Lift the lowest rate to 7.5% (being the lowest net benefit received under the former R&D Tax Concession).
- Exclude capital expenditure and cost of goods sold expenditure from 'expenditure' definitions to ensure a fairer application across all industry sectors.
- Maintain the calculation on an R&D entity basis, noting the tax anti-avoidance rules.

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

- We are disappointed to see the program targeting a specific industry sector. While it will have a positive impact for the life sciences sector, it is deliberately choosing a 'winner' over other important sectors that would also benefit from uncapped R&D (e.g. energy & resources, manufacturing and agri-business). We understand the benefit of R&D tax programs is that they do not 'pick winners' but rather provide a broader incentive based on R&D criteria as originally defined in the Frascati Manual. This fundamentally differs by selecting an industry sector that may have perceived additional societal benefits without publicly released analysis. It seems strange not to incentivise industries where Australia has a competitive advantage that we want to maintain.
- We note that the clinical trial definition does not include animal studies, which are often needed in pre-clinical stages. The definition could arguably be extended for this.

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

- Assuming the finding process is optional and the company can choose to self-assess, then we are comfortable with the process outlined.

Recommendation: To avoid picking 'winners', we would leave the R&D benefit uncapped. If this definition must remain then it may be worthwhile considering broadening it to include animal studies. Additionally, the finding process to determine 'clinical trials' should remain optional with companies allowed to self-assess.

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

- We are glad to see changes to the feedstock and clawback rules such that companies should no longer be unintentionally penalised.
- We are pleased to see the same 'adjustment' mechanism apply across both clawback and feedstock. This will make it easier to apply rather than having two different calculation methods.
- We do note that R&D entities with less than $20m aggregated turnover will no longer receive a small net benefit for the difference in the tax offset rate and adjustments required for certain feedstock or grants related expenditure.

- The clawback rules will still be onerous to apply in practice given timing differences of the receipt of grant funding and entitlements, and differences in what grants subsidise compared with eligible R&D expenditure. This issue compounds for companies that receive more than one grant during a year.
- We note that the balancing adjustment calculations for assets used partially in R&D under section 40-292 of the ITAA 1997 have not been changed to reflect the rate changes. This will lead to additional allowable deductions beyond original policy intent in certain circumstances and additional assessable income beyond the benefits received in other circumstances.

Recommendation: The draft law for feedstock and clawback adjustments appears reasonable. However, we would recommend a review of the balancing adjustment provisions to apply as intended. We would request that the ATO continue to provide an administrative concession for companies not wanting to claim feedstock expenditure.

Other recommendations/comments:

- We welcome the proposed additional guidance material and additional funding for reviews/audits. This should ensure the program continues to be appropriately accessed.
- We are concerned about the public release of company specific R&D information such as a single company's R&D expenditure claimed. For companies that do not publicly release their financial statements, this may have negative consequences. Knowing a competitor's R&D spend in competitive industries can be detrimental. We have had some clients raise concerns and question whether they will continue to access the program if their R&D expenditure information is released publicly.

5. Conclusion

In summary, we understand the Government's goal to enhance additionality, integrity and fiscal affordability. However, we are concerned that the changes will not increase additionality but rather reduce business expenditure on R&D, leading to decreased productivity.

The program has gone through a number of changes since its implementation in 2011. The continual modification, even in part, causes business uncertainty and has shown to have detrimental effects on business expenditure on R&D.

We recommend the government reconsider the R&D intensity threshold in its entirety. However, should this remain, the benefit rates must be lifted from 4%, as this would be the world's lowest R&D benefit. We recommend lifting this to at least 7.5%.

The definition of 'expenditure' will cause additional compliance complexity. However, should this be maintained, we recommend excluding capital and cost of goods sold expenditure to be fair across all industry sectors. Additionally, it should only be calculated on an R&D entity basis, noting the anti-avoidance rules.

While we look forward to increased guidance from both the ATO and AusIndustry, we question the need to publicly release company specific R&D information, especially for smaller claimants in competitive industries.

At a time of increasing global competition for innovation, we must continue to support R&D initiatives through indirect and direct funding. These proposed changes reduce the government's spending on R&D when other countries world-wide are increasing their spending.

We support structured changes to the R&D program to ensure it continues to be sustainable in the long-term; however, this needs to be done in direct consideration of the impact on Australia's innovation ecosystem. The changes, as drafted, do not appear to adequately consider this.

We thank you for the opportunity to respond to this consultation and look forward to policy certainty and stability moving forward.