IT'S HOW
WE CONNECT

22 January 2014

Chairman
Senate Standing Committees on Economics
PO Box 6100
Parliament House
Canberra ACT 2600
Email: Economics.sen@aph.gov.au

Dear Chairman

SUBMISSION TO THE SENATE ECONOMICS COMMITTEE INQUIRY INTO TAX LAWS AMENDMENT (RESEARCH AND DEVELOPMENT) BILL 2013

Telstra welcomes the opportunity to respond to this Inquiry.

If you would like further information or wish to discuss this submission you can contact me

Yours sincerely

James Shaw
Director, Government Relations
Telstra Corporation

IT'S HOW
WE CONNECT

Telstra Submission

ISSUE DATE: 22 JANUARY 2014

TESLTRA CORPORATION LIMITED'S SUBMISSION TO THE SENATE ECONOMICS COMMITTEE INQUIRY INTO TAX LAWS AMENDMENT (RESEARCH AND DEVELOPMENT) BILL 2013

IT'S HOW WE CONNECT

Telstra Submission

Telstra welcomes the opportunity to respond to this inquiry.

Overview

Innovation is a key driver of productivity for our company and our customers. Telstra believes passionately that innovation is important to this country and to our collective productivity and competitiveness. To be successful in an increasingly competitive global environment, Australia needs to do more, not less, to innovate and Research and Development (R&D) plays a key role in this. Telstra believes that R&D and innovation should be addressed holistically and further championed and supported by Government. It is regrettable that this taxation change appears to have been taken as a savings measure in isolation of any broader policy package to promote innovation, including R&D activities. Telstra believes removing the concession as an isolated fiscal measure sends the wrong signal to the business and broader community about the value placed on R&D.

Alongside our customers, Telstra engages with small and medium Australian and international technology enterprises and start-ups through direct investment, partnerships, licences to market products and through our technology incubator Muru-D. Through this variety of relationships, and our own R&D work, Telstra is committed to finding new and better ways to serve our customers. While some of these activities are not directly related to the R&D incentive they are evidence of our commitment to innovation and technology in Australia.

Innovation, research and development and productivity

It is generally accepted that increased productivity is required to achieve improved economic growth and increased living standards[i][ii][iii][iv]. Telstra is of the view that innovation policy, including R&D, plays an important role in contributing to broader productivity improvements. We also believe that the removal of the R&D concession for certain large taxpayers will have a negative impact on this important area of economic activity.

The former Department of Innovation, Industry, Science and Research made the link between R&D and productivity:

> "Economic research supports the link between research and development (R&D) and productivity. The Organisation for Economic Co-operation and Development (OECD) has identified that public and private R&D exert significant effects on productivity in Australia. It found that a 1 per cent increase in business R&D led to a long run increase in productivity of 0.11 per cent, with a comparable result of 0.28 per cent for public research. The scale of this is significant against an average annual rate of growth in multi-factor productivity of 0.8 per cent over the last decade."[v]

They further made the point that smaller firms are not as capable of undertaking R&D as are larger firms[vi].

At the heart of improving productivity is the desire to more efficiently and effectively use inputs to increase production, output and ultimately living standards. Large corporations seek to improve their levels of productivity to benefit their shareholders, staff and customers. Yet the way in which those productivity benefits can be achieved vary. Changes in work practices and greater use of technology are the most traditional ways of boosting productivity. In the area of Information and Communication Technology (ICT), in which Telstra principally operates, it is widely acknowledged that productivity is being driven by the rollout of new technology and ways of working[vii].

However more forward looking, and ultimately more transformational, step changes in productivity invariably require investment such as through R&D.

Large businesses are generally resourced to undertake transformational and nation-building infrastructure developments. Such large-scale projects produce "flow-on" impacts to the broader economy, including employment and attraction of foreign investment. At a time when business is being encouraged to address productivity and innovation, Telstra believes removing the concession, for the largest corporate taxpayers as an isolated fiscal measure, sends the wrong signal.

The Government has indicated its support for innovation as a key component of Australia lifting its competitiveness and retaining and growing Australian jobs. Telstra endorses the sentiment of the Assistant Treasurer that the Commonwealth Government wants to encourage more Australian companies to be able to commercialise local innovation[viii]. We believe maintaining the R&D tax concession is consistent with this objective.

The link between the R&D incentive and undertaking R&D

The former Treasurer justified excluding large companies from the R&D incentive on the basis that "... it is recognised that small firms are more responsive to R&D tax incentives than large firms". That is, it assumes that large companies will still undertake R&D regardless of the R&D incentive. Alongside the arguments in favour of R&D from the (former) Department[ix], that state it is in fact larger companies that have more capacity to undertake R&D, Telstra considers this proposition to be flawed for the following reasons:

- R&D is a business cost like any other cost. Increasing the after-tax cost of R&D will discourage investment, if only at the margin. It will also mean that Australia will become a relatively more expensive place in which to undertake R&D. By way of comparison, Singapore has continued to attract R&D to be undertaken there and has increased its R&D deductions to 400 percent (from 150 percent) on the first 400,000 Singapore dollars of eligible expenses. Other nations also compete for investment on the basis of their concessional R&D rates.

- Whether or not the R&D incentive encourages the largest companies to undertake any additional R&D than they would otherwise, it certainly encourages them to undertake those R&D activities in Australia (either directly or through contracted R&D with enterprises in Australia including small and medium enterprises). Such activities create jobs in Australia and result in wages, salaries and profits all of which are taxable in Australia. The OECD in a conference on knowledge-based capital last year specifically highlighted the role global tax incentives may have on reducing domestic employment[x].

- The exclusion of the largest companies from accessing the R&D incentive was part of a reform package brought in by the former Government aimed at "Supporting Australian industry to win business abroad" and "Helping Australian small and medium business to grow and create new jobs". It is difficult to see how this will be achieved if the large spenders on R&D are not encouraged to conduct their activities in Australia. The removal of the incentive will, we believe, have negative flow-on effects on the Australian labour force; not just those employed by the largest companies but also those smaller Australian companies that undertake R&D on behalf of the large companies. This may lead to the scaling down of innovation work undertaken in Australia if it becomes less attractive to undertake R&D activities here.

Limiting this change to only certain taxpayers

Alongside those substantive concerns it is unusual to have a piece of tax legislation, other than one targeting a specific tax base such as petroleum, that discriminates against a small group of taxpayers (the former Treasurer stated, in Media Release No. 27 of 2013, that: "The change will affect less than 20 corporate groups").

Telstra believes that, despite its categorisation as a savings measure, the public policy rationale beyond that has not been made for the removal of this incentive in the way this Bill proposes.

The impact of the change on Telstra Corporation

Telstra continues to look for better ways to serve our customers and to create a brilliant connected future for everyone. As technology continues to evolve at a rapid pace, Telstra has sought to remain at the forefront of global trends and investing in R&D is an important part of us achieving that objective.

There are enhanced ways of working, as well as products and services used by Australian businesses and consumers that were developed by Telstra in Australia with the benefit of the R&D concession. These include:

- **Digital Business (now Digital Office Technology)**- Development of a new solution to provide business customers with an integrated, hosted application and network services offering using advanced IP (Internet Protocol) technologies.

- **Enhanced exchanges**- A future-proof solution which replaced existing copper-based business services in the South Brisbane Exchange Service Area with new fibre offerings, which also enables these business offerings to be made available in other Telstra fibre-only exchange areas, providing Telstra with a significant opportunity to move into the future with a single step.

- **Telstra T Box**- Design and development of an innovative Set Top Box product offering encompassing a novel back-end framework, content delivery over an unmanaged network whilst ensuring Quality of Service, and an innovative device front-end user experience.

Telstra is further advancing its innovation agenda outside of the R&D incentive area. It has announced an innovation incubator in Muru-D to foster local technology innovation, by identifying and supporting start-ups to develop their products and services. We received over 300 applications from start-ups keen to receive $40,000 in addition to in-kind support such as mentoring.

As a proud Australian company, and one with an increasing global footprint, the R&D Tax Incentive has been one of the reasons behind Telstra's commitment to undertake the majority of our R&D work onshore, and where we partner with our vendors to undertake R&D on our behalf; we have

IT'S HOW WE CONNECT

Telstra Submission

mandated this requirement with them. While the incentive is not the only reason Telstra undertakes R&D onshore it is a valid consideration and any change to the nature of the incentive will be considered by Telstra as a factor in undertaking our business.

Conclusion

The Government has indicated a strong desire to "first and foremost deal with economic growth"[xi] and as part of its G20 agenda to look at "reducing impediments to private sector investment"[xii]. These are objectives Telstra welcomes and supports. To further its agenda the Government has announced reviews of competition and taxation policies. Given the R&D incentive goes to the competitiveness of Australia, Telstra contends that decisions around issues such as R&D tax concessions should be taken in the context of the wider innovation environment and innovation policy settings and not as an isolated fiscal measure.

---

[i] "Understanding Productivity, Australia's Choice", Report from the McKell Institute, The importance of productivity is made by the Chair and Executive Director of the Institute in the forward as well as by the authors throughout the substantive report http://mckellinstitute.org.au/wp-content/uploads/2012/11/McKell_Productivity_Report_A4.pdf (last accessed on 21 January 2014)

[ii] One of the first media releases issued by Prime Minister Abbott MP following the 2013 federal election indicated the importance of boosting productivity, http://www.liberal.org.au/latest-news/2013/11/08/boosting-productivity-and-delivering-effective-efficient-government (last accessed on 21 January 2014)

[iii] Then Treasurer Chris Bowen was reported in July 2013 media story that boosting productivity was a key challenge for Australia's economy http://www.theaustralian.com.au/national-affairs/policy/chris-bowen-says-economy-faces-not-a-crisis-but-a-challenge/story-fn59nsif-1226681336266# (last accessed on 21 January 2014)

[iv] Cowan, S, "Productivity is more than industrial relations" (blog post), 26 July 2013 http://www.cis.org.au/publications/ideasthecentre/article/4870-productivity-is-more-than-industrial-relations (last accessed on 21 January 2014)

[v] Innovation and Raising Australia's Productivity Growth, Submission to the House of Representatives Standing Committee on Economics Inquiry into Raising the Level of Productivity Growth in the Australian Economy in September 2009, page 1 http://www.innovation.gov.au/Innovation/ReportsandStudies/Documents/InnovationandRaisingAustraliasProductivityGrowth.pdf (last accessed on 21 January 2014)

[vi] Ibid, p.1-2

[vii] ICT Study Workforce July 2013, Australian Workforce and Productivity Agency, Forward by Chair includes the line "Across our economy, ICT is driving innovation and productivity" with further examples across the document. http://www.awpa.gov.au/publications/Documents/ICT-STUDY-FINAL-28-JUNE-2013.pdf (last accessed on 21 January 2014)

[viii] http://www.theaustralian.com.au/business/companies/sinodinos-says-government-keen-to-unlock-funds-for-innovation/story-fn91v9q3-1226769065237# (last accessed on 21 January 2014)

[ix] Innovation and Raising Australia's Productivity Growth, op cit

[x] Growth, Innovation and Competitiveness- Maximising the benefits of Knowledge- based capital,OECD Conference Papers, February 2013, Paris, http://www.oecd.org/sti/ind/Background%20Notes%20-%20ALL%20web.pdf , page 6 (last accessed on 21 January 2014)

[xi] Treasurer Joe Hockey, "The Task Ahead" Speech to the Centre for Independent Studies, 8 November 2013, accessed via Treasurer's media centre, http://jbh.ministers.treasury.gov.au/speech/002-2013/ (at beginning of section 1.1 Growth) (last accessed on 21 January 2014)

[xii] Ibid, (towards end of section 1.1 Growth)