Labor Senators' Minority Report

1.1 Tax incentives are recognised as one of the most effective tools available to government for stimulating and attracting investment in innovation. This investment, in turn, is critical to the development of dynamic and highly productive industries, able to compete at the top of the global value chain. As the Australian Industry Group notes:

> Innovation by business, including innovation associated with business engagement with research and development, is critical to the future success of the Australian economy. It is particularly important at the moment because we have a legacy of low productivity growth to address and because there is a need for new sources of growth to emerge to assist the economy rebalance as the boom in mining investment wanes.[1]

1.2 The point was recently echoed by Mr Glenn Stevens, Governor of the Reserve Bank of Australia, joining the growing consensus that 'a culture of innovation is the real key to the challenges of economic transition.[2]

1.3 This is not a matter that can simply be left to chance. The global competition for research talent and investment capital is intense—and with good reason. Every nation wants the jobs, skills and opportunities that go hand in hand with R&D investment.

1.4 Australia has every reason to enter this competition with confidence. As numerous submissions to the committee have affirmed, the excellence of our scientific institutions and the talents of our research workforce—when partnered with our stable investment climate and strong intellectual property framework—are an attractive proposition for global investors.

1.5 The fact remains, we cannot afford to be complacent about these advantages or fall behind in the race for new technologies. All sides of politics acknowledge the obligation of governments, state and federal, to showcase and nurture our strengths for the future. In this respect, the significance of our R&D tax environment cannot be emphasised too strongly.

1.6 Submission after submission points to the R&D Tax Incentive as an important, even decisive factor for companies looking to allocate their highly prized research dollars. Telstra, one of our largest R&D investors, notes:

> 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,

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1 Australian Industry Group, *Submission 18*, p. 1.

2 Mr Glenn Stevens, *House of Representatives Standing Committee on Economics Hansard*, 7 March 2014, p. 11.

> and where we partner with our vendors to undertake R&D on our behalf; we have mandated this requirement with them.[3]

1.7 At a time when companies like Telstra and the automotive manufacturers, another significant R&D investor group of companies, are offshoring jobs, it is now more critical than ever to ensure their R&D spend—and the jobs it creates—remain in Australia.

1.8 Given the importance of this measure, and the need for clear signals to prospective investors, any changes must be approached with great caution and underpinned by a compelling policy rationale. As Mr Serg Duchini of Deloitte submitted:

> It is clear that attracting innovation and its contribution to domestic prosperity depends on more than favourable tax policy decisions, but recent studies have confirmed that business expenditure on R&D is indeed strongly influenced by stable innovation policy.[4]

1.9 That is not to say that the policy framework should be static. On the contrary, it is important that the policy keep pace with the needs of modern business and the nature of modern research.

1.10 The Labor Government recognised this need with the pivotal reforms of 2011, which replaced the old concession with a credit, tightened the eligibility criteria to focus on genuine R&D, and lifted the level of support for both smaller and larger firms. The impact was immediate. In the first year alone, the number of firms registered grew by 15 per cent; and the total sums invested grew by 20 per cent. In the same year, the Labor Government committed to introducing R&D quarterly credits from 1 January 2014 as a further measure to boost R&D expenditure.

1.11 All of these measures were proposed and adopted with the benefit of widespread consultation across the innovation community, in and beyond Australia. In this way they affirmed—rather than called into question—our long-term commitment to this vital policy.

1.12 The Government now proposes to add a third tier to the eligibility requirements for the R&D Tax Incentive, with the result that very large companies with aggregate Australian assessable income of $20 billion or more would no longer be able to claim the R&D Tax Incentive.

1.13 It is true that this proposal stems from a measure put forward by the Labor Government in February 2013. That measure, however, must be understood in context. It was not an isolated savings measure, but the means of funding an ambitious package focussed on innovation policy, *A Plan for Australian Jobs*, centred on

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3 Telstra, *Submission 14*, pp. 4–5.

4 Mr Serg Duchini, Deloitte, *Proof Committee Hansard*, 21 February 2014, p. 4.

strategic industry-led Innovation Partnerships. These Partnerships would have the scale to attract major global investments in Australian firms and research institutions. They were, in other words, a new means to the same end: working with business to build jobs for Australians.

1.14 That rationale is gone. The Abbott Government has made no commitment to the job-building measures the previous Labor Government tied to the changes to the R&D Tax Incentive. Nor has it earmarked the savings from this measure for the vital task of lifting R&D investment. It is simply ripping support from innovators in business.

1.15 As Michael Johnson Associates notes:

> As acknowledged elsewhere in the Explanatory Memorandum, this is a savings measure and to brand it as better targeting of the Incentive is misleading.[5]

1.16 The submissions are almost unanimous in their opposition to this bald grab for any available 'savings'—savings that exact a heavy toll in jobs lost, capabilities impaired and talent sent offshore with no corresponding benefit introduced.

1.17 Three risks in particular are highlighted.

1.18 The first is the obvious risk of major R&D investments from very large companies heading offshore, with neither the R&D Tax Incentive nor the Innovation Partnerships to attract them. It cannot be put more clearly than in KPMG's submission:

> The estimated savings of $1.1 billion gained by the proposed changes are flawed and will provide the Government with at best a small increase in consolidated revenue now at the price of longer term growth in Australia in future.[6]

1.19 The argument has been put by the majority of the Committee that larger organisations are less receptive to tax incentives than smaller firms. The underlying assumption is that larger firms have the will and capacity to make these investments without the need for government prompting.

1.20 The evidence for this argument is far from clear.[7] What is certain is that these companies have the flexibility to direct their research investments to the jurisdiction they judge most attractive. Cost is clearly a relevant consideration, as is the

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5 Michael Johnson Associates, *Submission 3*, p. 4.

6 KPMG, *Submission 1*, p. 1.

7 Australian Industry Group, *Submission 18*, p. 1; Michael Johnson Associates, *Submission 3*, p. 3.

commitment to innovation displayed by the national government. On both fronts, this Bill risks sending investment from 'the companies that spend the most'[8] offshore.

1.21 The second risk is the flow-on impact to small and medium enterprises, in addition to Australian research institutions (including universities and public agencies such as the CSIRO). The point was well made in evidence by Mr Duchini, who cited the SME technology company Gekko Systems as an example.[9] As a research partner, Gekko is naturally concerned that the changes will discourage our largest firms from building collaborative ventures with Australian businesses.

1.22 The University of New South Wales notes that 30 per cent of its research effort at is supported by business entities directly impacted by the proposed changes.[10] The Innovation Partnerships, along with the move to quarterly credits, might have alleviated these concerns. The Government's proposal does not.

1.23 The third risk is the 'perverse outcome', as KPMG notes, of a large foreign company receiving preferable tax treatment in Australia to an Australian company of equivalent size.[11] It is an unfortunate message to be sending to local industry at this time.

1.24 Labor is keenly aware of the challenges facing many Australian firms as a result of the unprecedented strength of the Australian dollar, the rapidity of technological change and the increased competition in both domestic and export markets. We are concerned by the crisis in the automotive sector with the coming loss of all three major vehicle producers. We are concerned by the mass lay-offs in the aluminium sector, aviation, and service industries, amongst other sectors. We are concerned that the Government has failed to lay down a coherent strategy for a shift from the resources boom to the jobs of the future—jobs in advanced manufacturing, creative industries and health technologies, to name a few.

1.25 This is not the time to be putting investments in future industries at risk.

1.26 Another concern to Labor members is the Government's decision to scrap the option of quarterly credits. Even if the ostensible rationale for the targeting of the R&D Tax Incentive to smaller firms is accepted, it is often smaller firms and innovative start-ups that have the most difficulty with cash flow and accessing capital. The flexibility of the quarterly credit is critical to the very firms and industries the Explanatory Memorandum claims the Governments wishes to support. This contradiction between stated aim and likely outcome is a mark of the incoherent and ill-considered approach by the Abbott Government to a vital national agenda.

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8 KPMG, *Submission 1*, p. 4.

9 Mr Serg Duchini, Deloitte, *Proof Committee Hansard*, 21 February 2014, p. 2.

10 University of New South Wales, *Submission 17*, p. 1.

11 KPMG, *Submission 1*, p. 6.

1.27 The Government has attempted to downplay the significance of measures in the Bill, in stark contrast to the position it adopted prior to the election.

1.28 Then Coalition Industry spokesperson Ms Sophie Mirabella MP responded to Labor's proposed Jobs Package with the claim that the 'change to the R&D tax concession [sic] casts doubt on the stability of tax policy and raises more concern about the sovereign risk of investing in Australia'.[12]

1.29 In its subsequent Manufacturing Policy Statement, the Coalition pledged that: 'We will therefore use the opportunity of the scheduled 2014 changes to the R&D Tax Incentive programme to review access to R&D tax support for many businesses that have been barred from possible access under a series of retrograde cost savings made by Labor'.

1.30 From this, the business community could reasonably conclude that the Coalition Government would maintain, if not expand, the generosity of the R&D tax environment. These same businesses are now left with only the certainty of a further review, further changes and—as is foreshadowed in this current revenue grab—further cuts.

Conclusion

1.31 Labor recognises that investments in innovation are critical to the future prosperity of Australians. We were and are prepared to work with business and researchers to ensure the innovation budget is used wisely. We are not prepared to stand by as the Government plunders that budget for savings.

1.32 This is the time for innovation to be the frontline of economic policy and the signals from the Government must prove it.

1.33 The evidence tendered to the Committee overwhelmingly argues against the changes proposed by the Government. Labor accepts this evidence and the flaws it points to in the Government's approach.

1.34 In our view the Government has not provided a credible rationale for the proposed cuts to the R&D Tax Incentive, particularly given its opposition to the corresponding innovation measures they were designed the fund and its lack of any other plan to use these savings to support innovation.

12 Sophie Mirabella MP, 'Industry joins Coalition on R&D Revenue Concerns', *Media release*, 19 February 2013.

1.35 For these reasons Labor does not support the majority report and is opposed to the Tax Laws Amendment (Research and Development) Bill 2013.

Senator Mark Bishop
Deputy Chair