

# Chapter 2

## Key issues

2.1 As noted in chapter 1, the bill contains four schedules that propose to amend various taxation laws to:

- abolish the mature age worker tax offset (schedule 1);
- abolish the seafarer tax offset (schedule 2);
- reduce the rates of the tax offset available under the research and development tax incentive (R&D tax offset) by 1.5 per cent (schedule 3); and
- update the list of specifically listed deductible gift recipients (schedule 4).

2.2 This chapter examines schedules 2 and 3 to the bill on which the committee received evidence. The committee did not receive evidence on schedules 1 and 4.

### **Schedule 2—abolishing the seafarer tax offset**

#### *Stakeholder views on schedule 2*

2.3 In their submissions, the Australian Shipowners Association (ASA), Shipping Australia Limited (SAL), the Maritime Union of Australia (MUA) and Farstad Shipping expressed the view that the seafarer tax offset should not be abolished.

2.4 The ASA explained that the seafarer tax offset was part of a range of measures introduced in 2012 that combined:

...to provide the opportunity for Australian businesses to participate in our international shipping activity and in doing so add value to the economy, secure major trade routes and grow employment opportunities for the most highly trained Australian maritime staff.<sup>1</sup>

2.5 In its submission, SAL argued that the shipping industry needs regulatory stability. They raised concerns that the removal of the seafarer tax offset may have the effect of discouraging future investment in the Australian shipping industry and possibly discouraging the employment of Australian seafarers in the future.<sup>2</sup> SAL stated:

Australia is an island nation that is absolutely dependent on maritime trade for its economy and indeed its survival. International shipping companies operate on a global commercial basis and will only chose to register their vessels in Australia if tangible benefits encourage them to do so. The economic benefits to Australia of becoming a successful shipping registry are likely to significantly outweigh the costs of implementing effective incentives.<sup>3</sup>

---

1 Australian Shipowners Association, *Submission 1*, p. 4.

2 Shipping Australia Limited, *Submission 22*, p. 2.

3 Shipping Australia Limited, *Submission 22*, p. 2.

2.6 The MUA also raised concerns about the need for certainty in shipping policy.<sup>4</sup>

*Benefits to employers*

2.7 In its submission, the ASA emphasised that the seafarer tax offset is a rebate to employers, not employees, whose take home pay remains unchanged.<sup>5</sup>

2.8 Both the ASA and MUA noted that the seafarer tax offset was in line with similar income tax arrangements offered to employers in many other developed countries (including Belgium, Denmark, Finland, France, Germany, Greece, Netherlands, Norway and Spain). The ASA and MUA argued that repealing this measure would greatly reduce the employment prospects of Australians in highly skilled maritime roles.<sup>6</sup>

*Low take up rates*

2.9 The MUA noted in their submission that the low uptake of the seafarer tax offset reflects the fact that there are very few eligible taxpayers (shipowners) that would be entitled to the seafarer tax offset.<sup>7</sup>

2.10 Farstad Shipping noted that if the seafarer tax offset were available to their organisation, it would greatly enhance the training and career opportunities that they are able to provide to their staff. In their submission, they advocated for a broader application of the seafarer tax offset.<sup>8</sup>

*Review of coastal trading*

2.11 Some submitters noted that the government was currently undertaking a coastal shipping review.<sup>9</sup> On 8 April 2014, the government announced an options paper on approaches to regulating coastal shipping in Australia. The Department of Infrastructure and Regional Development sought views from stakeholders and is currently in the process of reviewing submissions received.<sup>10</sup>

2.12 In its submission, SAL argued that it may be better to wait until the review is finalised before making the decision to abolish the seafarer tax offset. SAL noted:

---

4 Maritime Union of Australia, *Submission 4*, p. 4.

5 Australian Shipowners Association, *Submission 1*, p. 6.

6 Australian Shipowners Association, *Submission 1*, p. 5; Maritime Union of Australia, *Submission 4*, p. 8.

7 Maritime Union of Australia, *Submission 4*, p. 4.

8 Farstad Shipping (Indian Pacific) Pty, Ltd, *Submission 3*, p. 1.

9 Maritime Union of Australia, *Submission 4*, p. 8; Shipping Australia Limited, *Submission 22*, pp. 1–2.

10 Department of Infrastructure and Regional Development, 'Review of Coastal Trading', [http://www.infrastructure.gov.au/maritime/business/coastal\\_trading/review/](http://www.infrastructure.gov.au/maritime/business/coastal_trading/review/) (accessed 16 October 2014).

---

Changes to coastal shipping regulations made as a result of this review may have an impact on the employment of Australian seafarers in the international trade; thus the retention of the offset may yet have the opportunity to deliver on its original intent.<sup>11</sup>

2.13 MUA expressed a similar view, arguing that abolishing the seafarer tax offset before the outcome of the review would 'demonstrate a piecemeal approach to shipping policy and create further uncertainty for ship investors.'<sup>12</sup>

### ***Committee view on schedule 2***

2.14 The committee notes the concerns expressed in the submissions, and would like to draw the issues raised in the evidence to the attention of the Department of Infrastructure and Regional Development for its consideration in finalising its review of coastal trading regulation.

2.15 Given the need to repair the budget, the committee recognises that savings have to be returned to the budget. Schedule 2 of the bill, if passed, would go some way to achieving this objective by delivering \$12 million in savings over the next four years.

### **Schedule 3—rates of the R&D tax offset**

#### ***Stakeholder views on schedule 3***

2.16 Innovation Australia is an independent statutory body which provides oversight for the R&D tax incentive as well as providing strategic advice to the Australian government. In its submission, Innovation Australia argued that the R&D tax incentive provides crucial support for innovation in Australian industry as well as support for developing new technology and industry. According to Innovation Australia, in the 2012–13 financial year the amount claimed under the program grew by 10 per cent.<sup>13</sup>

2.17 Innovation Australia noted and supported the decision not to extend the amendments to the R&D tax incentive proposed in the bill beyond changes to the reduction in the rate of the offset. For example, Innovation Australia supported the fact that the eligibility criteria of companies claiming the R&D tax offset; the way the incentive is claimed; and the administration of the R&D tax incentive would not be changed by the bill.<sup>14</sup>

2.18 Research Australia noted that the R&D tax offset provides:

...an incentive for innovative companies to spend money on R&D in areas they determine, without the Government mandating what areas the R&D should apply to or 'picking winners'.<sup>15</sup>

---

11 Shipping Australia Limited, *Submission 22*, pp. 1–2.

12 Maritime Union of Australia, *Submission 4*, p. 8.

13 Innovation Australia, *Submission 23*, p. 1.

14 Innovation Australia, *Submission 23*, p. 2.

15 Research Australia, *Submission 10*, p. 5.

### *Policy certainty*

2.19 Innovation Australia noted the need for policy stability and certainty, as research which results in the development of new technologies and breakthrough advances generally requires longer term investments.<sup>16</sup>

2.20 AusBiotech submitted that the 'constant threats and tweaks to the R&D Tax Incentive are unsettling for business and undermine business and investor confidence at a time Australia can least afford it'.<sup>17</sup> They explained:

The negative impact that uncertainty of funding support has on product development/innovation companies is destabilising and the Government's program changes cause one of the greatest costs, in practical terms. As well as making it more difficult to attract investment, uncertainty strikes companies in two ways: firstly companies are not sure whether the measures they have put in place, the deals they have struck and the investments made are going to receive the benefit(s) the Government previously pledged; and secondly, those that have not made commitments yet are sure to hesitate and wait for a more stable environment.<sup>18</sup>

2.21 AusBiotech also advised that they have received feedback from overseas investors that they 'intended to invest in Australian innovation but saw the regular changes to policy as discouraging risk'.<sup>19</sup>

### *Link to the company tax rate reduction*

2.22 Innovation Australia observed that the 1.5 per cent reduction in the company tax rate is not scheduled to commence until 1 July 2015, while the bill proposes to reduce the rate of the R&D tax offset from 1 July 2014. This will have the effect of creating a short term reduction in the R&D tax offset for the 2014–15 financial year.<sup>20</sup>

2.23 Innovation Australia suggested that, in order to eliminate the uncertainty created by the short term reduction in the R&D tax offset, the commencement date for the reduction in the rate of the R&D tax offset be postponed until at least 2015, when the lower company tax rate comes into effect.<sup>21</sup>

2.24 Ernst & Young raised similar concerns in its submission. Ernst & Young also expressed concern that there was no guarantee that the company tax rate reduction would be passed into law at the proposed time. As such, if any delays or changes were to occur this would prolong the reduction in the net benefit for R&D entities.

---

16 Innovation Australia, *Submission 23*, p. 2.

17 AusBiotech, *Submission 7*, pp. 3–4.

18 AusBiotech, *Submission 7*, p. 7.

19 AusBiotech, *Submission 7*, p. 7.

20 Innovation Australia, *Submission 23*, p. 2.

21 Innovation Australia, *Submission 23*, p. 2.

---

Ernst & Young raised concerns that 'this type of inconsistency can discourage R&D investment by both small and large companies within Australia'.<sup>22</sup>

2.25 Research Australia also expressed concerns about the potential for delays in the implementation of the reduction in the company tax rate.<sup>23</sup>

2.26 PricewaterhouseCoopers noted that one of the reasons for the 2011 decision to shift from an R&D tax concession to a tax credit regime was to ensure that any revision to the corporate tax rate did not affect the incentive.<sup>24</sup>

2.27 The BioMelbourne Network also advocated delaying the changes to the R&D tax incentive until the reduction in the company tax rate was enacted. In addition, the BioMelbourne Network recommended that the R&D tax incentive be maintained at 45 per cent for companies in areas of 'identified comparative and competitive advantage, such as medical technology and pharmaceuticals'.<sup>25</sup>

#### *Companies permanently impacted by the rate reduction*

2.28 PricewaterhouseCoopers noted that for some companies the negative impact of the proposed changes would not be limited to the 2014–15 financial year. Instead, the rate reduction would effect them on a permanent basis. PricewaterhouseCoopers explained that at least two significant sets of companies would permanently sustain the full 1.5 per cent rate reduction. These companies are:

- companies with more than \$5 million in taxable income, and
- small and medium enterprises (SMEs) and startups with carry forward income tax losses.<sup>26</sup>

#### *Companies with more than \$5 million in taxable income*

2.29 PricewaterhouseCoopers noted that companies with more than \$5 million in taxable income will be required pay 1.5 per cent in tax upon the introduction of the government's Paid Parental Leave Scheme. For these companies, the 1.5 per cent corporate tax cut will be effectively neutralised by the introduction of a 1.5 per cent levy linked to the Paid Parental Leave Scheme. PricewaterhouseCoopers noted that as such the R&D tax offset rate reduction would be a permanent reduction for these companies.<sup>27</sup>

2.30 Research Australia raised similar concerns, noting that the only companies that may not be adversely affected by the change in the R&D tax offset would be

---

22 Ernst & Young, *Submission 6*, p. 2.

23 Research Australia, *Submission 10*, p. 10.

24 PricewaterhouseCoopers, *Submission 13*, p. 3.

25 Biomelbourne Network, *Submission 9*, p. 3.

26 PricewaterhouseCoopers, *Submission 13*, p. 2.

27 PricewaterhouseCoopers, *Submission 13*, pp. 2–3.

companies with an annual turnover in excess of \$20 million that are not liable for the Paid Parental Leave levy.<sup>28</sup>

*SMEs and startups in a tax loss position*

2.31 Innovation Australia noted in its submission that SMEs with turnover below \$20 million where the offset is in excess of a company's income tax liability would be adversely affected beyond the 2014–15 financial year. Innovation Australia stated:

This will adversely impact these firms' cash flows and could result in a reduction in their R&D activity. In the experience of Innovation Australia, cash flows are important to such entities as they tend to be heavily constrained while devoting all their resources to developing their innovations.<sup>29</sup>

2.32 Research Australia submitted that the most significant component of the R&D tax incentive is the refundable R&D tax offset, which is only available to smaller companies with an annual turnover of less than \$20 million. Research Australia noted that these entities had received \$4.96 billion in support for R&D from 2011–12 to 2013–14. In comparison, over the same period the non-refundable R&D tax offset provided \$2.53 billion in support to companies with annual turnover of more than \$20 million.<sup>30</sup>

2.33 Research Australia noted that the reason for the inclusion of the refundable component in the R&D tax incentive is that many smaller companies operate at a loss for many years as they develop products for market, and therefore pay little or no income tax. Research Australia noted:

In this situation, the reduction in the rate of the R&D tax incentive is not 'revenue neutral', and in fact results in a direct reduction in the support provided to small innovative companies in their early stages when [they] need it most.<sup>31</sup>

2.34 The Chief Scientist for South Australia did not support the changes to the R&D tax offset. The Chief Scientist submitted that:

South Australia is particularly vulnerable to any such reduction. As an SME-dominated state facing enormous challenges with the loss of the automobile industry, and potentially also defence manufacturing, we cannot afford to put further pressure on our innovative SMEs.<sup>32</sup>

2.35 The BioMelbourne Network expressed concern that the proposed amendment would have a disproportionate impact on the smallest and most vulnerable companies, as the R&D tax incentive is:

---

28 Research Australia, *Submission 10*, p. 10.

29 Innovation Australia, *Submission 23*, p. 2.

30 Research Australia, *Submission 10*, p. 8.

31 Research Australia, *Submission 10*, p. 9.

32 Chief Scientist for South Australia, *Submission 8*, p. 1.

...particularly critical for start-ups, spin-outs and SMEs who are in tax loss, as the cash refund has allowed these entrepreneurial enterprises to maintain consistent R&D programs for longer.<sup>33</sup>

2.36 AusBiotech expressed a similar concern that the changes will 'discriminate against small start-up biotechnology and other R&D-based companies'.<sup>34</sup>

2.37 Innovation Australia did not advocate for a different rate to apply to these firms. However, it submitted that the adverse impact on them should be noted, 'especially as these are likely to be the companies with the highest growth and employment prospects in the future'.<sup>35</sup>

*Subdivisions 355-G and 355-H of the ITAA 1997*

2.38 In its submission, BDO Australia provided an explanation of subdivisions 355-G and 355-H of the ITAA 1997. It noted:

Subdivision 355-G operates to 'clawback' the incentive through an increase in tax payable where a Government grant has been received. Subdivision 355-H makes an adjustment to assessable income to 'clawback' the incentive received on feedstock inputs where a company sells or otherwise applies to its own use a marketable product it has created. In effect, these provisions are designed to clawback the 10% incentive component afforded under the current 40% non-refundable tax offset.

2.39 In relation to subdivisions 355-G and 355-H of the ITAA 1997, the Explanatory Memorandum states:

For simplicity, no change has been made to the provisions providing for the adjustment of tax benefits in respect of eligible research and development expenditure, where the entity obtains a recoupment for the expenditure or sells feedstock to which the expenditure relates. Following the proposed reduction in the company tax rate, the tax outcomes for entities to which these provisions apply will be largely the same as before these amendments.<sup>36</sup>

2.40 BDO Australia expressed concern that the bill does not make any provision for consequential amendments to subdivisions 355-G and 355-H of the ITAA 1997, nor Section 12B of the *Income Tax Rates Act 1986*, which establishes the rate of extra income tax for recoupments of R&D activities, for the period before the corporate tax rate is reduced.<sup>37</sup>

2.41 BDO Australia noted that the Explanatory Memorandum indicated that the reason no change had been made to these provisions was 'for simplicity'. However, BDO Australia pointed out that:

---

33 Biomebourne Network, *Submission 9*, p. 1.

34 AusBiotech, *Submission 7*, p. 2.

35 Innovation Australia, *Submission 23*, p. 2.

36 Explanatory Memorandum, p. 20.

37 BDO Australia, *Submission 15*, p. 2.

...reducing the incentive component to 8.5% and not amending these provisions creates an absurd situation where companies may in fact be penalised for undertaking eligible R&D activities.<sup>38</sup>

2.42 With regard to subdivision 355-G relating to income tax recoupments of R&D activities, Ernst & Young expressed concern about the decision not to amend this rate so that it was in line with the reduction in the rate of the R&D tax offset. Ernst & Young's submission stated:

We are not aware of any intention in the Tax and Super Laws Amendment Bill to amend or update this 10% rate. This suggests that an unintended consequence of the reduction of the R&D tax offset rates is a negative 1.5% outcome for R&D entities that access the 38.5% non-refundable R&D offset and also obtain a recoupment from government for the expenditure. In this scenario the entity would potentially be facing 10% recoupment tax but only receive 8.5% net R&D benefit.<sup>39</sup>

2.43 KPMG raised similar concerns, noting:

Each of these adjustments can also be impacted by the timing of the expenditure compared with the timing of the adjustment as these can occur in different income years. Given this increased level of complexity, the most sensible approach would be to make any reduction to the R&D offset rate at the same time as the reduction in the corporate tax rate. This would potentially also avoid the need for further amendments to these adjustments when the corporate tax rate is reduced.<sup>40</sup>

2.44 Ernst & Young recommended that, if it is not possible to align the changes to the R&D incentive and company tax rate, that Section 12B of the *Income Tax Rates Act 1986*, which establishes the rate of extra income tax for recoupments of R&D activities, be amended to reflect the proposed change in the R&D offset rates.<sup>41</sup>

#### *Taxation White Paper*

2.45 A number of submitters, including Reproductive Health Science, Redarc Electronics, the Australian Wine Research Institute, and De Bruin Engineering noted that the proposed reduction in the R&D tax offset immediately precedes the tax white paper. They expressed the view that this serves to 'generate unwarranted confusion, uncertainty and unpredictability in the government's approach to taxation'.<sup>42</sup>

---

38 BDO Australia, *Submission 15*, p. 2.

39 Ernst & Young, *Submission 6*, p. 2.

40 KPMG, *Submission 16*, p. 2.

41 Ernst & Young, *Submission 6*, p. 3.

42 See: The Australian Wine Research Institute, *Submission 2*, p. 1; Cell Therapy Manufacturing Cooperative Research Centre, *Submission 5*, p. 2; Research Australia, *Submission 11*, p. 1; BioSyngas Limited, *Submission 12*, p. 2; Zonge Engineering and Research Organization (Australia), *Submission 14*, p. 1; KPMG, *Submission 16*, p. 3; Redarc Electronics, *Submission 17*, p. 2; Scantech Limited, *Submission 18*, p. 1; Reproductive Health Science Ltd, *Submission 19*, p. 1; Deep Exploration Technologies Cooperative Research Centre, *Submission 20*, p. 2; De Bruin Engineering, *Submission 21*, p. 2.



2.46 Innovation Australia advised that as part of the forthcoming taxation white paper, it anticipates a review of the performance of the R&D tax incentive program. It explained:

Anticipation of the review and subsequent changes is creating uncertainty among industry stakeholders and could result in reduced expenditure or postponement of R&D projects. This is another reason for limiting the changes being made to this program, at least by postponing the proposed reduction in rate of the R&D Incentive until 1 July 2015.<sup>43</sup>

### ***Committee View on Schedule 3***

2.47 The committee acknowledges that the submissions raised a number concerns regarding the reduction in the rate of the R&D tax offset and the need for policy certainty. The committee considers that the upcoming taxation white paper will provide a useful opportunity for wide consultation to be undertaken relating to R&D and government incentives to encourage R&D. However, the future scheduled reviews do not mean that the R&D tax incentive cannot be amended in the meantime if necessary.

2.48 The committee draws the government's attention to the concerns raised by a number of submitters, including Innovation Australia, regarding the discrepancy between the commencement dates for the reduction in the rate of the R&D tax offset (1 July 2014) and the proposed company tax rate cut (1 July 2015).

2.49 The committee notes however that the reduction in the rate of the R&D tax offset is a savings measure. This measure will provide a gain to the Budget of \$620 million in fiscal balance terms over the forward estimates period. In underlying cash terms this is a gain to the Budget of \$550 million over the forward estimates period.

### **Recommendation 1**

**2.50 The committee recommends that the Senate pass the bill.**

**Senator Sean Edwards**  
**Chair**

---

43 Innovation Australia, *Submission 23*, pp. 2–3.

