The Senate

Economics
Legislation Committee

Tax and Superannuation Laws Amendment
(2014 Measures No. 5) Bill 2014 [Provisions]

October 2014

ISBN 978-1-76010-106-0

Printed by the Senate Printing Unit, Parliament House, Canberra.

Senate Economics Legislation Committee

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Chapter 1

Introduction and overview of the bill

1.1 On 25 September 2014, the Senate referred the provisions of the Tax and Superannuation Laws Amendment (2014 Measures No. 5) Bill 2014 (the bill) to the Senate Economics Legislation Committee for inquiry and report by 28 October 2014.[1]

1.2 The bill, which contains four schedules, proposes to amend the *Income Tax Assessment Act 1997* (ITAA 1997), the *Taxation Administration Act 1953* and the *Shipping Reform (Tax Incentives) Act 2012* 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).

1.3 The Selection of Bills Committee stated that the bill was referred to the Economics Legislation Committee to 'seek key stakeholder feedback on the impact of the legislation on research and development'.[2]

Conduct of the inquiry

1.4 The committee advertised the inquiry on its website and wrote to relevant stakeholders and other interested parties inviting submissions. The committee received 24 submissions, including one confidential submission, which are listed in the Appendix. The committee did not to hold a public hearing for this inquiry.

1.5 The committee thanks all of the individuals and organisations that contributed to this inquiry.

Structure of this report

1.6 This report comprises two chapters:

- chapter 1 provides an overview of the bill and detail about the consideration of the bill by other parliamentary committees; and
- chapter 2 discusses the issues and concerns about the bill that have been raised in public submissions received by the committee.

Overview

The 2014–15 Budget context

1.7 In the 2014–15 Budget, the government outlined its Economic Action Strategy. The government committed to 'repairing the Budget' and stated it was taking

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1 *Journals of the Senate*, no. 56 of 2014–15 (25 September 2014), p. 1506.

2 Selections of Bills Committee, *Report No. 12 of 2014*, September 2014, Appendix 11.

steps to 'ensure the Government is living within its means, and to rein in the age of entitlement'.[3]

1.8 In his second reading speech, the Hon Steven Ciobo MP, Parliamentary Secretary to the Treasurer, stated:

> This bill represents another chapter in the government's Economic Action Strategy.
>
> We inherited from Labor an unsustainable budget position. The measures in this bill will return around $1.4 billion to the budget over the forward estimates.[4]

The schedules of the bill

Schedule 1—abolishing the mature age worker tax offset

1.9 Schedule 1 proposes to repeal Subdivision 61-K of the ITAA 1997 to abolish the mature age worker tax offset (MAWTO).

1.10 MAWTO is a concessional tax offset which was introduced in 2004–05. The offset was intended to provide an incentive to mature age workers to remain in the workforce. The maximum tax offset available for eligible mature age workers is $500 per year. When MAWTO was introduced it was available to taxpayers who were aged 55 or over, and who had a net income from working. The former government started to phase out MAWTO in July 2012 by restricting access to taxpayers born before 1 July 1957.[5]

1.11 The proposal to abolish MAWTO was announced in the 2014–15 Budget. At the same time, the government announced that it would redirect savings from this measure to the government's *Restart* program. Through the *Restart* program, from 1 July 2014 a payment of up to $10,000 will be available to employers who hire a mature age job seeker (aged 50 years or over) who has been receiving income support for a minimum of six months.[6]

Schedule 2—abolishing the seafarer tax offset

1.12 Schedule 2 of the bill proposes to amend the ITAA 1997 to abolish the seafarer tax offset from 1 July 2015.

1.13 The seafarer tax offset was introduced in 2012 as part of a policy reform package, *Stronger Shipping for a Stronger Economy*. The aim of the reform package

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3 The Hon Joe Hockey MP, Treasurer, and Senator the Hon Mathias Cormann, Minister for Finance, *2014–15 Budget Joint Media Release*, 13 May 2014, http://jbh.ministers.treasury.gov.au/media-release/021-2014/ (accessed 19 October 2014).

4 The Hon Steven Ciobo MP, Parliamentary Secretary to the Treasurer, Second Reading Speech, *House of Representatives Hansard,* 4 September 2014, p. 4.

5 Explanatory Memorandum, p. 7.

6 Australian Government, *2014–15 Budget: Budget Paper No. 2,* May 2014, pp. 14 and 97; Explanatory Memorandum, p. 8.

was to make the Australian shipping industry more internationally competitive and help remove barriers to investment in Australian shipping.[7]

1.14 The intention of the seafarer tax offset was to encourage companies to employ Australian seafarers. The offset is provided to companies for salaries, wages and allowances paid to an Australian resident who is employed on overseas voyages on certified vessels for at least 91 days in an income year.[8]

1.15 The Explanatory Memorandum noted that since its introduction in 2012, fewer than 20 taxpayers have claimed the seafarer tax offset annually, in respect of, in total, around 250 employees. The Explanatory Memorandum goes on to state that:

> The low level of claims for the seafarer tax offset indicates that it has not achieved its policy intent. It has not been an effective stimulant for the employment of Australian seafarers on overseas voyages.[9]

1.16 In his second reading speech, the Hon Stephen Ciobo MP stated:

> The current regulatory regime for shipping imposes a cost on shippers and their customers. Because it is a part of a current shipping regulation, the Seafarer Tax Offset effectively imposes a cost on all Australian taxpayers.[10]

1.17 The government announced the proposal to abolish the seafarer tax offset in the 2014–15 Budget. The savings from this measure 'will be redirected by the Government to help repair the Budget and fund other policy priorities'.[11]

1.18 The Hon Stephen Ciobo MP told the Parliament that removing this offset was 'expected to save the government $12 million over four years. And that is another small step towards repairing the budget'.[12]

Schedule 3—rates of the R&D tax offset

1.19 Schedule 3 of the bill proposes to amend the ITAA 1997 to reduce the rates of the tax offset available under the research and development tax incentive by 1.5 per cent from 1 July 2014.

1.20 In its current form,[13] the incentive provides:

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7 Explanatory Memorandum, *Tax Laws Amendment (Shipping Reform) Bill 2012*, p. 5.

8 Explanatory Memorandum, p. 13.

9 Explanatory Memorandum, p. 14.

10 The Hon Steven Ciobo MP, Parliamentary Secretary to the Treasurer, Second Reading Speech, *House of Representatives Hansard*, 4 September 2014, p. 4.

11 Australian Government, *2014–15 Budget: Budget Paper No. 2*, May 2014, p. 212.

12 The Hon Steven Ciobo MP, Parliamentary Secretary to the Treasurer, Second Reading Speech, *House of Representatives Hansard*, 4 September 2014, p. 4.

13 The *Tax Laws Amendment (Research and Development) Bill 2013* is currently before the Senate. For further information about the amendments proposed in this bill, refer to the relevant report of this committee: Senate Economics Legislation Committee, *Tax Laws Amendment (Research and Development) Bill 2013*, 17 March 2014.

- a 45 per cent refundable tax offset to eligible entities with a turnover of less than $20 million, and which are not controlled by income tax-exempt entities, for their expenditure on eligible research and development activities in Australia; and
- a 40 per cent non-refundable tax offset to all other eligible entities for their expenditure on eligible research and development activities in Australia.[14]

1.21 The proposed amendment will reduce the higher (refundable) rate of the tax offset from 45 per cent to 43.5 per cent and the lower (non-refundable) rate of the tax offset will be reduced from 40 per cent to 38.5 per cent.[15]

1.22 This measure was announced in the 2014–15 Budget, reducing the relative value of the research and development tax incentive in line with the government's commitment to cut the company tax rate by 1.5 per cent from 1 July 2015. The Budget papers stated:

> The gain to revenue and savings from this measure will be redirected by the Government to repair the Budget and fund policy priorities.
>
> This measure is estimated to provide a gain to the Budget of $620.0 million in fiscal balance terms over the forward estimates period. In underlying cash terms, the gain to the Budget is $550.0 million over the forward estimates period.[16]

1.23 The Explanatory Memorandum notes that the research and development tax incentive is the 'primary mechanism by which the Commonwealth seeks to encourage companies to undertake research and development activities in Australia'.[17]

1.24 In his second reading speech, the Hon Stephen Ciobo MP, Parliamentary Secretary to the Treasurer, stated:

> Changing the offset will affect neither the eligibility of companies for the R&D tax incentive nor the way the companies claim the incentive.
>
> Nor will the changes affect the administration of the R&D tax incentive more generally.[18]

1.25 The Hon Stephen Ciobo MP went on to state:

> If this measure were not enacted, the cut to the company tax rate would entail an increase in the benefit provided by the R&D tax incentive relative to the normal treatment of business expenses.[19]

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14 Explanatory Memorandum, p. 17.

15 Explanatory Memorandum, p. 17.

16 Australian Government, *2014–15 Budget: Budget Paper No. 2,* May 2014, p. 18.

17 Explanatory Memorandum, p. 17.

18 The Hon Steven Ciobo MP, Parliamentary Secretary to the Treasurer, Second Reading Speech, *House of Representatives Hansard,* 4 September 2014, p. 5.

19 The Hon Steven Ciobo MP, Parliamentary Secretary to the Treasurer, Second Reading Speech, *House of Representatives Hansard,* 4 September 2014, p. 5.

1.26 The Department of Industry noted that as part of the process of Budget repair, the government sought savings from a wide range of areas:

> As part of this process, the Government made a difficult decision to reduce the rate of benefit to all companies under the R&D Tax Incentive effective from 1 July 2014, subject to legislative processes.[20]

1.27 With regard to consultation, the Explanatory Memorandum stated:

> Targeted confidential consultation was undertaken on exposure draft legislation with affected stakeholder bodies. No concerns were raised during consultation.[21]

Schedule 4—deductable gift recipients

1.28 Schedule 4 proposes to amend the ITAA 1997 to update the list of specifically listed deductable gift recipients (DGRs).

1.29 DGR status assists eligible entities and funds to attract public financial support for their activities. The income tax law allows taxpayers to claim income tax deductions for gifts of two dollars or more to DGRs.[22]

1.30 The amendments proposed in schedule 4 will add Australian Schools Plus Ltd, East African Fund and the Mindaroo Foundation Trust as specifically listed DGRs.[23]

Consideration of the bill by other committees

Senate Scrutiny of Bills Committee

1.31 The Senate Standing Committee for the Scrutiny of Bills assesses legislative proposals against a set of accountability standards that focus on the effect of proposed legislation on individual rights, liberties and obligations, and on parliamentary propriety. The Scrutiny of Bills Committee—which reported on the bill in its twelfth *Alert Digest* of 2014—focused on the retrospective application of the proposed amendments. The Scrutiny of Bills Committee noted that the proposed measures in schedule 1—abolishing the mature age worker tax offset and schedule 3—rates of the R&D tax offset, commence on 1 July 2014. The Scrutiny of Bills Committee noted that both measures were announced in the 2014–15 Budget, and made no further comment on the bill.[24]

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20 Department of Industry, 'Research and Development Tax Incentive', http://www.industry.gov.au/science/policy/Pages/RDTaxIncentive.aspx (accessed 20 October 2014).

21 Explanatory Memorandum, p. 19.

22 Explanatory Memorandum, p. 23.

23 Explanatory Memorandum, p. 23; the Explanatory Memorandum provides further information on each of these entities, pp. 23–24.

24 Scrutiny of Bills Committee, *Alert Digest No.12 of 2014*, p. 12.

Parliamentary Joint Committee on Human Rights

1.32 One of the functions of the Parliamentary Joint Committee on Human Rights (PJCHR) is to examine bills for compatibility with human rights, and to report to both Houses of the Parliament on that issue.[25] The PJCHR considered that the bill was 'compatible with human rights'.[26]

25 *Human Rights (Parliamentary Scrutiny) Act 2011*, s. 7(a).

26 Parliamentary Joint Committee on Human Rights, *Examination of legislation in accordance with the Human Rights (Parliamentary Scrutiny) Act 2011: Twelfth Report of 44th Parliament,* September 2014, p. 22.

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.[1]

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.[2] 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.[3]

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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.[4]

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.[5]

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.[6]

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.[7]

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.[8]

Review of coastal trading

2.11 Some submitters noted that the government was currently undertaking a coastal shipping review.[9] 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.[10]

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:

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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/ (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.[11]

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.'[12]

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.[13]

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.[14]

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'.[15]

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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.[16]

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'.[17] 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.[18]

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'.[19]

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.[20]

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.[21]

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.

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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'.[22]

2.25 Research Australia also expressed concerns about the potential for delays in the implementation of the reduction in the company tax rate.[23]

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.[24]

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'.[25]

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.[26]

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.[27]

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.[28]

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.[29]

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.[30]

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.[31]

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.[32]

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:

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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.[33]

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

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'.[35]

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.[36]

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.[37]

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:

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33 Biomelbourne 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.[38]

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.[39]

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.[40]

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.[41]

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'.[42]

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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.[43]

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

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

Labor Senators' Dissenting Report

1.1 Labor Senators oppose the abolition of the schedule 2—seafarer tax offset and the reduction in the schedule 3—rates of the R&D tax incentive.

Seafarer Tax Offset

1.2 Labor Senators oppose the abolition of this measure, rejecting the Abbott Government's attempt to remove the measures Labor introduced to revitalise Australian shipping.

1.3 The object of this offset is to stimulate opportunities for Australian seafarers to be employed or engaged on overseas voyages, and acquire maritime skills, benefiting employers of Australian seafarers.

1.4 Labor Senators emphasize that there were no submissions to the inquiry supporting the abolition of the seafarer tax offset. This includes diverse stakeholders such as the Australian Shipowners Association, Shipping Australia, and the Maritime Union of Australia.

1.5 The Government is attempting to abolish the seafarer tax offset less than two years after it was introduced, without giving it an opportunity to expand Australia's maritime skills base.

1.6 This tax initiative was one of several that arose from the lengthy industry consultations that led to Labor's Shipping package.

1.7 It is in Australia's national and security interest to revitalise the Australian shipping industry. We are an island nation; one-tenth of the world's trade goes to or from Australia, the fourth largest shipping task in the world.

1.8 Labor Senators note the evidence provided opposing the repeal of this offset by the Australian Shipowners Association to this inquiry:

> The Seafarers Tax Offset was a key element of the 2012 reforms which helped to reduce the operating costs of Australian vessels, increased the competitiveness of Australian shipping and provided significant opportunity for employment of Australians in international trades…the impact [of abolition] is severe with regard to future opportunity.[1]

R&D tax incentive

1.9 In advanced industrial economies, innovation is the principle driver of increases in productivity. Firms that innovate are more competitive and can sustain more high-skilled, high-paid jobs.

1.10 Tax incentives are one of the most effective tools available to government for stimulating and attracting investment in innovation. This investment, in turn, is critical to developing dynamic and highly productive industries, able to compete at the top of the global value chain.

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1 The Hon Chris Bowen MP, *House of Representatives Hansard*, 24 September 2014, p. 25.

to developing dynamic and highly productive industries, able to compete at the top of the global value chain.

1.11 In the 1980s Labor introduced the R&D tax concession, making Australia one of the first countries in the world to foster innovation through the taxation system.

1.12 The Labor government updated the scheme in 2011, and the positive effect of the new measure was immediate. Data from the Department of Industry shows that 'There has been significant growth in the number of new firms undertaking R&D under this programme, with a 49 per cent increase in 2011–12 and a further increase of at least 9 per cent in 2012–13.'

1.13 The R&D Tax Incentive was a landmark reform, building on Labor's record of investment in innovation and R&D. Today, though still relatively new, it is an important feature of Australia's innovation policy framework and encourages companies to invest in R&D.

1.14 The current proposal to reduce the rate of the R&D Tax Incentive by 1.5 per cent is supposed to be consistent with the Government's pledge to cut the company tax rate from 1 July 2015 by maintaining the relative value of the offsets.

1.15 The R&D Tax Incentive was intended to be independent of the company tax rate, ensuring the level of benefit provided remains constant and provides certainty for R&D investors, regardless of any fluctuations in the company tax rate.

1.16 This was clarified in *Powering Ideas: the Labor Government's Innovation Agenda for the 21st Century*, which states the R&D Tax Incentive 'increases certainty by uncoupling the level of R&D support from the corporate tax rate' (2008, p. 47). This point was acknowledged by the Department of Industry in response to a written question from Budget Estimates hearings held from 2 to 3 June 2014:

> Under the R&D Tax Incentive the rates are independent of the company tax rate, therefore the level of benefit provided remains constant, and therefore certain, regardless of changes to the company tax rate.

1.17 Labor Senators note that 19 of the 23 public submissions made to the inquiry into Tax and Superannuation Laws Amendment (2014 Measures No. 5) Bill 2014, were responding directly to provisions in the bill that seek to reduce the rates of the tax offset. Each of these submissions is critical of the government's proposed changes.

1.18 The most pressing concern for stakeholders is the increasing uncertainty this measure will create for the business community, by actively discouraging investment in R&D. This is precisely the situation the Labor Government was trying to avoid when it introduced the R&D Tax Incentive, making it independent of the company tax rate.

1.19 As noted by KPMG:

> When the R&D tax incentive was first introduced, it was the Government's intention that providing a tax offset rather than a deduction would mean that changes in the corporate tax rate would not impact the R&D incentive. That

is, companies had the certainty that they would continue to get a 40 per cent or 45 per cent offset regardless of the corporate tax rate.[2]

1.20 Likewise, BDO stated that:

> …the key driver to change the delivery of the incentive from additional deductions to a tax offset was for the very purpose of decoupling the incentive from the corporate tax rate thereby improving investment certainty.[3]

1.21 Ensuring certainty and business confidence is especially important in R&D intensive sectors, such as the life sciences. As noted in the submission from AusBiotech:

> Constant threats and tweaks to the R&D tax incentive are unsettling for business and undermine business and investor confidence at a time when Australia can least afford it.[4]

1.22 Similarly, BioMelbourne Network notes that 'Certainty around the maintenance of this initiative is critical to Australian businesses and the Australian economy' and that:

> The proposed reduction in the R&D tax offset will have a real negative impact on the ability of BioMelbourne Network members to develop and deliver health products and services to the Australian public.[5]

1.23 The uncertainty and policy inconsistency created by the proposed change cannot be overstated, and concerns about the impact of this change on R&D investment in Australia are repeated in almost all submissions to the committee.

1.24 As noted by Ernst & Young, 'This type of inconsistency can discourage R&D investment by both small and large companies within Australia;' and as noted by KPMG, 'The rate reduction limits companies' ability to plan their long term R&D investments' and 'Through its conduct, the Government is actively dissuading companies from doing R&D in Australia.'

1.25 Labor Senators also note that the decrease in the R&D tax rate will especially harm small research-intensive firms that are generating little profit. For these companies, the reduction in the R&D rate will not be offset by an associated reduction in the company tax rate, as they are not likely to be paying tax.

1.26 As noted by BioMelbourne Network:

> The amendment will also have a disproportionate impact on companies operating with a tax loss and currently receive the R&D tax incentive as a refund. This impacts the smallest and most vulnerable companies, such as

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2 *Submission 16*, p. [1].

3 *Submission 15*, p. [2].

4 *Submission 7*, p. 1.

5 *Submission 9*, p. [2].

> start-ups, 'spin-outs' and SMEs, who make up a majority of companies in Australia's pharmaceutical and medical technology sectors.

1.27 This point is echoed by PricewaterhouseCoopers, which stated that 'some companies will be impacted on a permanent basis rather than for just one income year.'[6]

1.28 Labor Senators also note that the proposed tax changes precede the release of a wide-ranging tax white paper, further adding to the uncertainty surrounding the future of the R&D Tax Incentive.

Senator Sam Dastyari
Deputy Chair

Senator Chris Ketter
Senator for Queensland

Senator the Hon Kim Carr
Senator for Victoria

6 *Submission 13*, p. 2.

APPENDIX

Submissions received

Submission Number	Submitter
1	Australian Shipowners Association
2	The Australian Wine Research Institute
3	Farstad Shipping (Indian Pacific) Pty Ltd
4	Maritime Union of Australia
5	Cell Therapy Manufacturing Cooperative Research Centre
6	Ernst & Young
7	AusBiotech
8	Chief Scientist for South Australia
9	BioMelbourne Network
10	Research Australia
11	Applidyne Australia Pty Ltd
12	BioSyngas Limited
13	PricewaterhouseCoopers
14	Zonge Engineering and Research Organization (Australia) Pty Ltd
15	BDO Australia
16	KPMG
17	Redarc Electronics
18	Scantech Limited
19	Reproductive Health Science Ltd
20	Deep Exploration Technologies Cooperative Research Centre
21	De Bruin Engineering
22	Shipping Australia Limited

23	Innovation Australia
24	Confidential