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TREASURY LAWS AMENDMENT (MAKING SURE MULTINATIONALS PAY THEIR FAIR SHARE OF TAX IN AUSTRALIA AND OTHER MEASURES) BILL 2018

Dear Sir/Madam,

We act on behalf of our client, MSM Milling Pty Ltd. The company welcomes the opportunity to provide feedback in response to the proposed R&D Tax Incentive amendments that form part of the provisions of the Treasury Laws Amendment (Making Sure Multinationals Pay Their Fair Share of Tax in Australia and Other Measures) Bill 2018 that was introduced to Parliament on 20 September 2018.

These materials outlined key areas where the Federal Government requests specific feedback on the implementation of reforms to the Research and Development Tax Incentive (R&DTI) to better target the program and improve its integrity and fiscal affordability in response to the recommendations of the 2016 Review of the R&D Tax Incentive.

Should you wish to discuss any of our comments, please feel free to contact me on [REDACTED]

Yours sincerely

[REDACTED]
Graham Wakeman
Tax Partner BDO East Coast Partnership



The Senate Standing Committee on Economics has sought feedback and comments from Industry on Treasury Laws Amendment (Making Sure Multinationals Pay Their Fair Share of Tax in Australia and Other Measures) Bill 2018 ('the bill'). A significant number of the provisions in this bill relate to amendments to the R&DTI.

It is our view that if certain of the proposed changes to the R&D Tax Incentive were to be introduced in their current form they would be detrimental to Australian taxpayers and accelerate the decline in Australia's 'Business Expenditure on R&D' (BERD).

MSM's key concerns and recommendations are as follows:

1. **Improve industry equality:** The proposed provisions will create disparity in the support provided to taxpayers in different industries. Key provisions including the 'intensity test' should be re-evaluated to ensure they promote industry equality.
2. **Reduce complexity:** The proposed changes such as the 'intensity test' introduce greater complexity and reduce the overall value of the R&DTI due to the additional cost of compliance for all programme stakeholders.
3. **Ensure a sufficient benefit is provided:** The increased cost of compliance combined with the reduction in offset rates may negate the benefit of the programme for MSM. The government should maintain a minimum after-tax benefit of 8.5% for large entities such as MSM.

BACKGROUND

MSM Milling Pty Ltd (MSM Milling) is a company based in Manildra, in the Central West of NSW. The company processes canola seed in its factory to produce high quality canola oil and meal. In terms of size, the company turns over approximately \$100M and employs approximately 75 staff. The business is family operated and the company principals have a farming background.

Reforming the Research and Development Tax Incentive.

The proposed changes to the R&DTI are based on some of the recommendations that came out of its 2016 review of the R&DTI and the subsequent 'Australia 2030: Prosperity through Innovation Report' ('The Review') released in January this year by the Board of Innovation and Science Australia (ISA). The Review found the Incentive was failing to fully achieve its objectives of generating additional R&D activities, was not well targeted, providing benefits for R&D activities that would have been undertaken without the Incentive, and the cost was exceeding initial estimates. The proposed changes are intended to improve the targeting of the Incentive and are estimated to have a net gain to the budget of \$2.4 billion in fiscal balance terms over the forward estimates period.

During the 2016 Review of the R&DTI programme BDO has previously emphasised the need to ensure that the administration and compliance burden on industry is minimised, whilst also meeting the Government's Science and Innovation agenda. The increased complexities and compliance requirements associated with identifying eligible activity and expenditure under the proposed changes to the program in our opinion are likely to offer little to no incentive for companies to access the R&DTI program, particularly those with a group turnover over \$20 million.

Furthermore, whilst the certainty that the existing program provides has led to activities that have generated new solutions and improved efficiencies for Australia, this is the second time since the R&DTI was introduced to replace the R&D Tax concession in 2011 that the government has introduced changes. A continually changing R&D program makes it difficult for many innovators to plan their R&D strategically particularly at a time when governments in other jurisdictions are increasing their support



of innovation. Furthermore, the changes introduce a number of measures that will only allow the tax benefit to be identified retrospectively.

MSM'S KEY CONCERNS WITH THE PROVISIONS' IMPACT ON INDUSTRY

Industry favouritism

The R&DTI program has supported Australian businesses as an industry agnostic incentive for over 30 years. The program was initially established to provide support to businesses of all sizes and across all industries, with the goal of encouraging innovation and advancement.

The draft legislation introduces for the first time a number of specific provisions that are detrimental to MSM Milling and other agricultural sector companies.

In its current form, the proposed legislation applying to non-refundable offset recipients discriminates against those businesses which operate in industries characterised by high turnover and low margins (including the agribusiness, manufacturing, and resources sectors) through the introduction of a new tiered non-refundable offset. This tiered mechanism is touted to provide proportionately larger R&D benefits to those companies with a high 'R&D intensity'.

However, under this tiered offset, companies with a turnover over \$20 million will be required to have an R&D intensity of greater than 13% to receive a greater offset than the current 38.5%. For companies operating in competitive sectors of the economy characterised by high turnover and low margins, this will ultimately be a significant disincentive for companies to innovate, become more efficient and achieve sustainable growth. In our experience, whilst MSM invests a significant proportion of its profits in creating new technology relating to canola, there is no likelihood that the company would ever be able to invest amounts in R&D that would get the business to an R&D intensity level of 13%, that would result in our level of assistance being comparable to the current 8.5% assistance regime.

The high turnover / low margin nature of the agricultural sector is not something that MSM has any control over. It is a characteristic of the particular markets (canola oil and meal) that the company is in and reflects the highly competitive nature of commodity sectors, many of which are subject to international pricing pressures and in which Australia has both a natural advantage and is internationally competitive.

As an internationally competitive company, MSM has been continuing to invest heavily in R&D in order to create innovative products and processes and attempt to add value to locally grown seed. It has often been said that the way forward for Australia's economic development is to invest in technology to create new ways to add value to our raw materials. MSM has done exactly that and under the proposed new legislation, the tax benefit to the company from their R&D investment falls from the current 8.5% to barely more than 4% with effect from 1 July 2018.

Quite apart from the significant reduction in the level of assistance provided, the complexity of the proposed new method of calculating the tax benefit makes it very difficult to work out exactly what the tax benefit is from investment in R&D. To replace a simple 8.5% benefit with a complex tiered rate of assistance applying marginal rates of benefit is clearly contrary to the industry assistance imperatives of simplicity and certainty. The revised calculation methodology provides neither.