



The Secretary
Senate Standing Committee on Economics
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Dear Sir/Madam

Submission: Tax Laws Amendment (Research and Development) Bill 2013

Please find below, our submission in relation to the Treasury Consultation Paper “Tax Laws Amendment (Research and Development) Bill 2013” (the Amendment) referred to the Senate Economics Committee (SEC) for inquiry on 5 December 2013.

Swanson Reed – Specialist R&D Tax Advisors

Swanson Reed is Australia’s largest specialist R&D tax provider.

Since its introduction in May 2009, Swanson Reed has conducted over 200 workshops on the R&D Tax Incentive and transition strategies from its predecessor program. The workshops have identified that many small and medium size enterprises (SMEs) are concerned that the program will be subject to much cost cutting in the future and accordingly have become hesitant to implement long term R&D tax planning strategies.

Swanson Reed is of the view that any measures demonstrating stable and generous support to SMEs’ Innovation, particularly in the manufacturing sector, will assist with improving confidence and entice them to invest in long term projects with spill over benefits to the economy.

Summary

Swanson Reed supports the Amendment and recommends that the savings are redeployed to assist SMEs within the Industry Portfolio.

- The R&D Tax Incentive is due to be over budget by \$304 million in 2013-14, and \$1.2 billion over the four years to 2016-17. The Government is under increased pressure to



reduce debt and any cost blowout must be carefully considered. The Amendment balances the cost blowout whilst having the smallest impact on the economy.

- Studies have found that small firms generate more innovations per dollar of R&D and that large firms may be less responsive to R&D Incentives since they have the means to finance R&D Activities without government support.
- The Government has committed to reducing the size of the public service. Administrative resources made available from the Amendment may be redeployed to alleviate future resourcing constraints.
- Australia must take measures to show it is committed to innovation and a stable business environment. This will inspire SMEs to undertake R&D Activities confident in the support available to them and will also allow large firms to make long term investment decisions based on a stable tax system.

The R&D Tax Incentive is over budget

The R&D Tax Incentive is due to be over budget by \$304 million in 2013-14, and \$1.2 billion over the four years to 2016-17. The blowout is the result of higher than expected refundable tax offsets during the first year of operation for SMEs with a turnover of less than \$20 million¹.

The Government is under increased pressure to reduce debt and during these uncertain times, any cost blowout must be addressed. The Amendment is estimated to produce savings of \$1.1 billion over the four year period and deny access to the R&D Tax Incentive to Australia's largest 15-20 firms². This measure essentially balances the cost blowout that the refundable tax offsets has caused.

The key question becomes, if the cost of the program is to be balanced, what group is to be subject to cuts:

1. the SMEs who are mainly responsible for the budget blowout?; or
2. the top 15-20 firms that as a collective group are a significant cost of the program?

The largest firms would likely maintain Australian R&D spend without an incentive

Although the decision to exclude the largest companies from claiming the R&D Tax Incentive is internationally unprecedented, there is evidence that large firms would most likely maintain

¹ Bowen, C & Wong, P. (2013). *Economic Statement*. Retrieved from http://www.budget.gov.au/2013-14/content/economic_statement/download/2013_EconomicStatement.pdf. p. 36.

² The Parliament of the Commonwealth of Australia. (2013). *Explanatory Memorandum – Tax Laws Amendment (Research and Development) Bill 2013*. p. 3.



Australian R&D spend. The Productivity Commission Research Report (2007) made comment that large firms are less likely to engage in additional basic R&D in response to government incentives, as “big firms have reasonable avenues to access finance for risky projects, internally through their capacity for diversifying risk or through conventional equity markets”³.

Although it is recognised that the R&D Tax Incentive is still in its infancy, based on past accumulated research, Swanson Reed is of the view that there would be an insignificant impact to the 15-20 largest firms in the event the R&D Tax Incentive were removed.

SMEs would likely suffer as a result of cuts to their R&D Tax Incentive entitlements

In comparison to large firms, SMEs are typically faced with financing constraints and have a strong reliance on internal funds to finance R&D investment⁴. Recent productivity reports have made the following key findings:

- Capital constraints may be more significant for small firms relative to large firms, thus increasing their reliance on government incentives to fund innovation⁵.
- The share of R&D undertaken by SMEs is generally greater in smaller economies. Firms with fewer than 250 employees accounted for 42 per cent of business R&D in Australia, while firms with fewer than 50 employees accounted for over one-fifth of business R&D⁶.

SMEs experience greater benefits and increase innovative activities in response to increased government support for R&D relative to large firms. Many empirical studies regarding innovation output and firm size have found that small firms generate more innovations per dollar of R&D⁷.

Swanson Reed is of the view that SMEs would suffer as a result of cuts to their R&D Tax Incentive entitlements.

AusIndustry staff could be redeployed to resource constrained areas

The Government has committed to reducing the size of the public service. It was reported in November 2013 that AusIndustry will cut jobs over many programs and that this will most likely

³ The Productivity Commission. (2007). *Public Support for Science and Innovation*. Retrieved from http://www.pc.gov.au/__data/assets/pdf_file/0016/37123/science.pdf

⁴ Mohnen, P & Baghana, R.. (2009). Effectiveness of R&D Tax Incentives in small and large enterprises in Quebec. *Small Business Economics*, 33(1), p. 91-107

⁵ Ortega-Argilés, R., Vivarelli, M. & Voigt, P. (2009). R&D in SMEs: a paradox?. *Small Business Economics*, 33(1), p. 3-11

⁶ The Productivity Commission. (2007). *Public Support for Science and Innovation*. Retrieved from http://www.pc.gov.au/__data/assets/pdf_file/0016/37123/science.pdf

⁷ Lee, S.J. & Marschke, G. (2009). Relation of Firm Size to R&D Productivity. *International Journal of Business and Economics*, 25(6), p. 795-803.



impact customer service⁸. The Amendment potentially may permit staff redeployment into resource constrained areas within the Department of Industry.

Additionally, recent AAT cases have highlighted that companies, (particularly SMEs) are having difficulty meeting the substantiation and other requirements of the R&D Tax Incentive and as a result many have been deterred from claiming. Swanson Reed has discovered that many companies would welcome additional guidance and focused assistance from AusIndustry regarding to substantiation requirements and identification of activities. The Amendment, if legislated would allow AusIndustry an opportunity to redeploy resources into customer service, so they may provide additional guidance and assistance to SMEs around tax compliance.

The Amendment must be subject to adequate consultation with Stakeholders

There is reported concern amongst stakeholders regarding the manner in which the proposed legislation has been developed.

The proposed abolishment of R&D Tax Incentives for large firms was initially raised among other measures by the Business Tax Working Group (BTWG) as a means to fund reduction to the company tax rate. The BTWG subsequently concluded within its report released on 13 April 2012 that more time was needed to understand the risks of proposed savings⁹.

It would appear that the relevant risk assessment and consultation underlying the proposed legislation is unlikely to have been conducted since the BTWG released its most recent report.

Previous decisions for project approvals by large firms will likely have been modelled assuming the ongoing availability of the R&D Tax Incentive and then reconsidered with the introduction of the Amendment.

It is important to provide all stakeholders with certainty regarding any potential change so that they may plan accordingly. Furthermore, inadequate consultation may lead to sovereign tax risk and lead to economic instability. Thus any stakeholder concerns regarding the consultation process must be carefully considered.

Swanson Reed acknowledges that the SEC inquiry process allows stakeholders a full, fair and reasonable opportunity to articulate concerns with legislating the Amendment. This process will help alleviate concerns regarding inadequate consultation during the previous Government.

⁸ Towell, N. (2013). *AusIndustry Staff Told to Expect Job Cuts*. Retrieved from <http://www.canberratimes.com.au/national/public-service/ausindustry-staff-told-to-expect-job-cuts-20131126-2y8gx.html>.

⁹ <http://www.treasury.gov.au/PublicationsAndMedia/Publications/2012/BTWG-Final-Report>.



Conclusion and Recommendations

Overall, Swanson Reed supports the Amendment. Although SMEs are responsible for the cost blowout, they must not be harmed through any future cost cut measure as this would have a severe impact on their confidence and capacity to conduct R&D Activities. If the budget is to be balanced, sacrificing the top 15-20 claimants appears to be a reasonable solution.

- The Amendment is estimated to balance the cost blowout while having the least amount of impact on the economy.
- The Government has committed to reducing the size of AusIndustry. Administrative resources made available from the Amendment may be redeployed to provide additional support to AusIndustry's many programs that foster Australian innovation.
- Australia must take measures to show it is committed to innovation and a stable taxation regime. This will inspire SMEs to undertake R&D Activities confident in the support available to them and will also allow large firms to make long term investment decisions based on a stable tax system.

Please do not hesitate to contact us on (07) 3221 1499 if you would like to discuss any aspect of this submission.

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