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By Email: economics.sen@aph.gov.au

Senate Standing Committees on Economics
PO Box 6100
Parliament House
Canberra
ACT 2600

Dear Sir / Madam,

Deloitte submission on Senate Inquiry into provisions contained in *Treasury Laws Amendment (Making Sure Multinationals Pay Their Fair Share of Tax in Australia and Other Measures) Bill 2018*

We were extremely pleased to see that the provisions of the above Bill were referred for inquiry on 18 October 2018, and note our comments for the consideration of the Committee both below and in the attached submission to a previous Treasury consultation.

We note at the outset that our submission is restricted to the key provisions in the Bill that relate to the proposed changes to the existing R&D Tax Incentive regime. The application of these provisions is in no way restricted to "multinational groups paying their fair share of tax". Rather, the R&D Tax Incentive assists a range of companies in conducting their R&D programs, the majority of which are small to medium enterprises. In our view this omnibus Bill mistakenly conflates a number of issues that are relevant to multinational businesses, with measures such as the R&D Tax Incentive which also assist small to medium enterprises.

As such, we strongly advocate that the first step in any subsequent process is the isolation of the R&D provisions into a separate Bill to allow the amendments to be properly considered and debated in isolation, rather than subsumed and glossed over as a multinational tax avoidance measure.

At a high level, the current R&D Tax Incentive regime has been in place since 2011, with previous revenue saving amendments having been enacted in 2014 and 2016. Despite a number of such revisions, such as changes to the rates of the incentive, we believe that the current regime has built on the success of the former R&D Tax Concession. The program has played a significant part in attracting increasingly mobile global capital to Australia, over a time when our global innovation rankings have fallen. In particular, Australia has seen a considerable increase in investment in the life sciences industry since 2011 due to a number of deliberate design elements such allowing overseas entities to fund and benefit from activities

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carried on in Australia, and the decoupling of the R&D Tax Incentive from the corporate tax rate. This decoupling provides certainty for enterprises when planning for long term R&D investment.

Our overwhelming view is that if the proposed measures are enacted, the long-term success of investment attraction to support innovative Australian based projects will irreversibly decline, since the proposed changes will result in a net tax benefit of 4% for most groups conducting R&D. This is in stark contrast to a new regime providing a 15% benefit being introduced across the Tasman (see below). Notably, in considering levels of support provided, the net tax benefit of the original Australian R&D Tax Concession was 24.5% for 1986-87. We also attach an infographic that reflects how the support provided by the Australia's R&D tax system has fallen over time.

Of further note is the impact that the recent small business tax cuts will have for start-ups and SMEs accessing the refundable aspect of the program. At a 25% headline corporate tax rate (in the near future) for these businesses, the aggregate refundable offset available will drop to 38.5% - from 45% in 2016. These start-ups and SMEs very often consider R&D refunds as a critical way of financing their innovation programs. This reduction in the refundable offset is substantial and will materially impact the cashflow, and in some cases the financial viability, of these highly innovative companies.

We understand the revenue savings of the current proposed amendments could be attractive in the current fiscal climate, and it has been publicly acknowledged that the savings will be taken rather than wholly redirected to direct innovation grants (as explicitly recommended by a number of recent reviews and reports).

Therefore, before the current Bill is debated in Parliament, we believe it is critical that the members of this cross-party Senate Committee should be wholly aware of the critical issues that we believe have been overlooked in the discussion and consultation on the implications of these far-reaching changes.

The ongoing rhetoric is that the proposed amendments have been based on the 2016 Review led by Bill Ferris. The changes were also originally sold as a package together with corporate tax rates cuts for all businesses; however these are cuts which will now not eventuate for all companies.

The elapse of time has instead revealed that the significant savings available will be accessed, rather than redirected as funding into the wider innovation system (as recommended in the 2016 report), with Mr Ferris himself publicly decrying the current proposals.

There are a number of significant structural and economic concerns with the proposed R&D changes, reflected across a wide range of key Australian industries. These are set out in detail in our attached submission to Treasury lodged in July of this year.

Notably, the R&D Tax Incentive has always been broad based as a central policy tenet. These measures will serve to introduce discrimination between industries and companies depending on their business models and global structure. Low-margin industry sectors will be punitively affected, and other companies will need to incur an enormous and unrealistic quantum of R&D expenditure even approach matching the existing 8.5% tax benefit available for larger companies.

The consultation documents have used unrealistic examples of the positive effects of the changes, which we believe would be highly unlikely to match any true profile of an operating Australian business. It has also not been recognised that the permanent $150 million cap may prevent a handful of the high intensity companies from actually accessing the higher premium rates proposed.

Aside from the significant fall in support for innovative Australian businesses, the introduction of the intensity threshold proposed is likely to actually encourage global businesses to potentially set up low cost R&D centres in Australia and retain administrative and training functions offshore, an unintended result that would not be conducive to Australia's employment and economic outcomes. We also believe that the changes could result in further unnecessary compliance and litigation in the longer term as companies seek to legitimately maximise their tax benefits.

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As noted above, the New Zealand government has also recently released draft legislation confirming a new 15% R&D Tax Incentive regime. Such competition in close geographic proximity, in a country also able to provide talent and political stability, will undoubtedly attract global investment, which could otherwise have been invested in Australia.

In summary, voting these changes through unchanged will certainly consign Australia to very low levels of support for innovation when compared to other OECD nations coupled with one of the highest corporate tax rates globally; a combined distinction we believe is not in the nation's long-term interests.

We would strongly encourage the Committee to take the time to adequately explore all aspects of the longer-term commercial and economic impacts of these proposed changes, the implications of which, if enacted, cannot easily be reversed.

We believe that the Committee members should discuss the changes with appropriate senior personnel in Australia's largest companies, especially those groups that have the capacity to move activities and inbound funding to other jurisdictions that will provide substantially more attractive regimes than Australia going forward.

Notably, a recent survey of Fintech entities carried out by another Big 4 accounting firm reflected the importance of the current R&D Tax Incentive scheme to their funding and success, and a desire to see this unchanged. It is important that the Committee also discusses the real implications of the proposed changes with Australian start-ups, Fintech and otherwise. It is the success of these entities on which Australia's future prosperity will be built.

There is no doubt that the future of Australia's innovation status, and its economic consequences, are at a critical cross-road. We believe it is vital for Australia's economic prosperity that these issues are subject to the proper scrutiny of the Committee, rather than pursued at all costs in the name of short-term fiscal savings.

As noted, to assist you in this, we attach the submission that we lodged in July of this year in response to the exposure draft legislation and consultation paper issued by Treasury in June. A number of other submissions should also be publicly available, which will provide other perspectives on the implications of these changes.

Unfortunately, the Bill introduced into Parliament in September disregarded almost all of the valid concerns raised during consultation by a wide-ranging number of stakeholders. The substantial measures of the Bill remain almost untouched, a reflection that the process to date has been less than transparent and that the key concern may be to access the resulting savings.

In closing, we would reiterate our concern that the measures were introduced in an omnibus Bill targeted at multinationals. As already mentioned, the R&D measures that dominate the Bill would, in reality, affect large numbers of small and medium sized start-ups and businesses, as the vast majority of registrants for the R&D Tax Incentive are small to medium enterprises. At a minimum, we believe that the Committee must recommend that the R&D measures are split into a separate Bill so that the amendments can be properly considered and debated in isolation, more ably informed by the conclusions that this Committee will come to.

We hope that this information will be of some assistance to the members of the Committee and would be pleased to discuss the issues further with you, either in person or as part of a formal Committee hearing.

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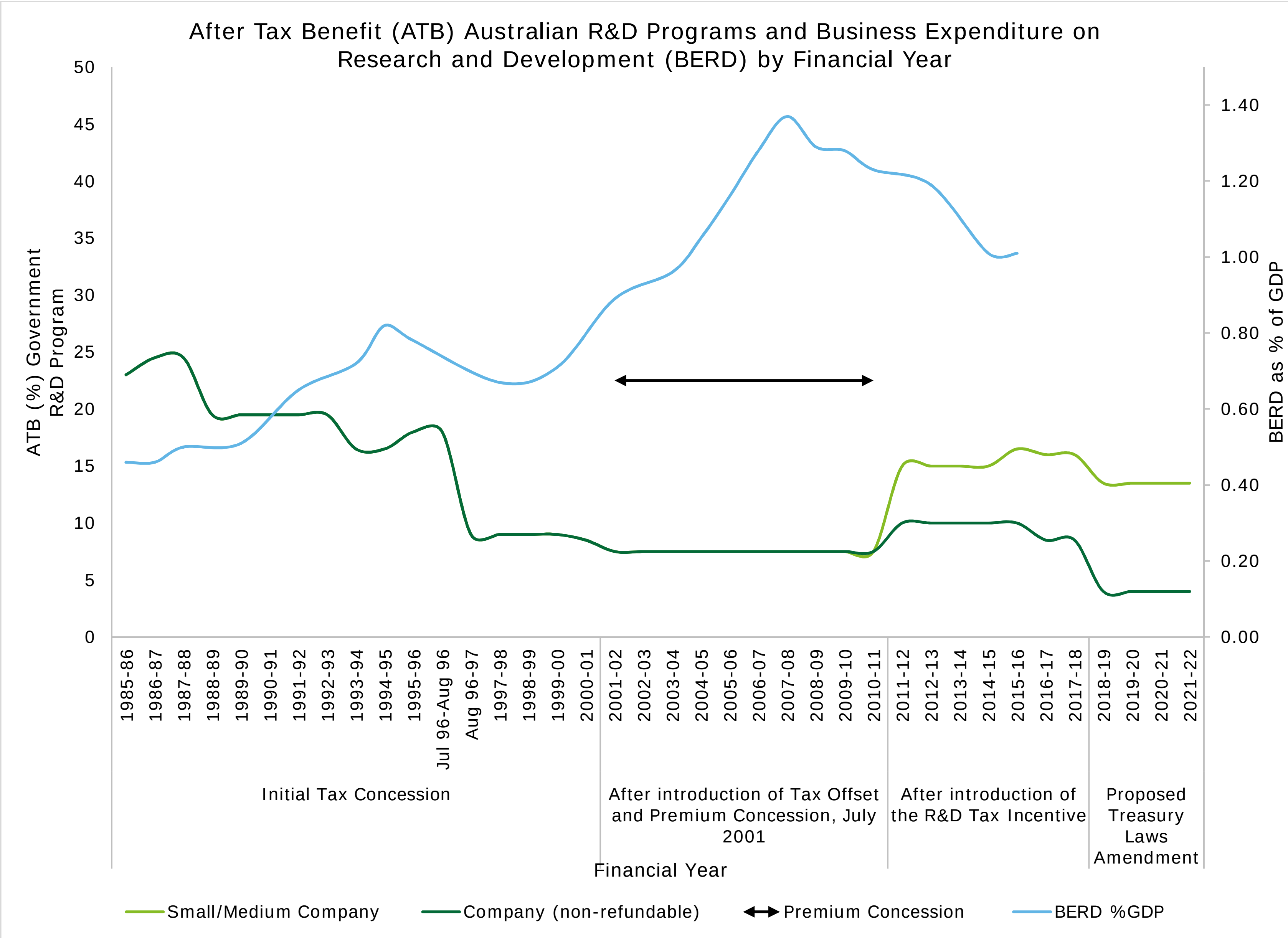
Yours sincerely

Greg Pratt
National Leader - Global Investment and Innovation Incentives (G*i*³)
Deloitte Tax Services Pty Ltd

Enc:

Deloitte submission on June 2018 R&D Tax Incentive Consultation Paper – July 2018

Infographic - R&D tax program support (net after tax benefit) and Business Expenditure on R&D


After Tax Benefit (ATB) Australian R&D Programs and Business Expenditure on Research and Development (BERD) by Financial Year
ATB (%) Government R&D Program
BERD as % of GDP
Financial Year
Initial Tax Concession
After introduction of Tax Offset and Premium Concession, July 2001
After introduction of the R&D Tax Incentive
Proposed Treasury Laws Amendment
1985-86
1986-87
1987-88
1988-89
1989-90
1990-91
1991-92
1992-93
1993-94
1994-95
1995-96
Jul 96-Aug 96
Aug 96-97
1997-98
1998-99
1999-00
2000-01
2001-02
2002-03
2003-04
2004-05
2005-06
2006-07
2007-08
2008-09
2009-10
2010-11
2011-12
2012-13
2013-14
2014-15
2015-16
2016-17
2017-18
2018-19
2019-20
2020-21
2021-22
Small/Medium Company
Company (non-refundable)
Premium Concession
BERD %GDP