Canva Submission to the Senate Economics Legislation Committee Review of the Treasury Laws Amendment (Research and Development Tax Incentive) Bill 2019

6 August 2020

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

Dear Sir/Madam,

We appreciate the opportunity to share our perspective as part of the Committee's review of this proposed Bill and the associated amendments to the Research and Development Tax Incentive ("RDTI").

Canva, a Sydney-based technology company seeking to empower the world to design, is keenly aware of the importance of incentives around innovation and R&D to the technology sector especially when you are initially trying to bring your ideas and passion to life. Building from our own experience, we felt it was important to contribute to the Committee's review of the proposed amendments to Australia's RDTI with specific focus on start-up technology enterprises.

We understand the proposed reforms aim to refocus support towards additional high intensity R&D expenditure, while also ensuring the program's effectiveness and integrity in response to the 2016 Review of the R&D Tax Incentive which found that the program fell short of meeting its stated objectives of supporting additionality and spillovers.

Many of the recommended changes are welcomed, including: increasing the expenditure threshold (although it is unclear if this will impact many R&D entities); enhancing guidance; streamlining administrative processes; and continuing to focus R&D incentives on areas where Australia has a competitive advantage with its highly skilled labour force (including in the software technology sector).

There are several proposed changes in the draft 2019 Bill where we offer the following observations.

Small-Medium R&D Enterprises (<$20 million in annual turnover)

The 2016 R&D review found that the program provided an unexpected benefit for R&D activities that would have been undertaken without the Incentive; however, an alternative view is that many R&D activities would never have been undertaken by Australian start-ups / small-medium enterprises without the RDTI. The 2019 Bill specifically proposes to limit small-medium R&D enterprises through the introduction of a cap on refundable offsets and by coupling the refundable rate to the enterprise's corporate tax rate which is likely to have the following implications:

1. $4m refundable RDTI cap – although it is unclear how many taxpayers a cap would impact (estimated at approximately 20 taxpayers), this new measure does not appear to support high intensity R&D expenditure in small-medium R&D enterprises. Alternatively, an uncapped incentive encourages more intense investment by entities eligible for refundable R&D offsets.
2. Rate of benefit coupled with income tax rate – the coupling of the RDTI with the small-medium enterprise corporate tax rate (27.5% and reducing to 25% in future years) will result in a significant decrease in refundable R&D offsets for Australian start-ups. This is amplified by the fact that the 2019 Bill is intended to be retroactively applied from 1 July 2019 impacting small-medium R&D enterprises who have budgeted

for refundable R&D tax credits to fund projects already under way in 2020 and possibly with R&D expenditure commitments beyond this timeframe.

We would also like to highlight an opportunity to align the small business turnover threshold of $20 million applied for assessing the application of refundable R&D tax incentives with the $50 million threshold used in determining whether an entity is a small enterprise for other provisions within Australian tax legislation. Given our experience as a start-up, the growth from $20 million to $50 million in annual revenue is not the game changer and can take a number of years to reach. As a supportive measure, reassessing the rationale of the $20 million threshold against the rationale under other tax measures would be prudent, especially considering the country's need to grow its economy due to the impacts of COVID19.

Large R&D Enterprises - Intensity Premiums

The current draft of the Bill introduces three intensity premiums based on the level of notional R&D expenditure as a percentage of the enterprise's total expenditure for the year. Financing for R&D expenditures is often dependent on the profitability of the R&D enterprise and given our country's current economic situation post the introduction of COVID19, many R&D enterprises will have reduced ability to support projected R&D spend. Enterprises who may have previously met the 4-9% R&D intensity range to retain their historical 38.5% non-refundable tax offset will see this reduced to 34.5% under the proposed changes likely impacting the entities ability to fund future R&D activities.

We would propose to revise the Bill to maintain the 38.5% non-refundable tax offset for large R&D enterprises and, as a stimulus measure, add the 12.5% intensity premium (resulting in a 42.5% non-refundable tax offset) for enterprises meeting the notional deductions representing greater than 9% of total expenses.

Transparency

The proposed Bill requires that the Commissioner must publish information about the R&D entities that have claimed notional deductions for R&D activities, including the amount claimed, balancing these objectives against the potentially commercially sensitive nature of the information being published. In that respect, the Commissioner must publish the following information:

- the R&D entity's name;
- the R&D entity's Australian Business Number, or Australian Company Number if that is the only number available; and
- an amount representing the R&D entity's notional deductions claimed taking into account any feedstock adjustments for the year.

Although the above information appears harmless, published information related to the amount of R&D spend on innovation will be available to competitors, both global and domestic, and although many public companies publish some information around R&D spend, keeping this information from the public realm is important for both start-up and larger private enterprises. As an example, publishing R&D spend (notional deductions) both in the first year and as a trend over time may signal to competition that Australian enterprises are gearing up for the launch of a new product and may inspire greater competition for Australian firms.

Based on the draft Bill, it is unclear if the transparency objectives provide a true benefit to the Australian economy and should be tested further to understand if the benefits will outweigh likely costs.

Retrospective Application

Currently, the Bill is set to apply retroactively from 1 July 2019 which we anticipate will have some unintended negative consequences.

The first impact relates to how small enterprises often seek to fund R&D expenditure through bridging loans that must be repaid upon receipt of the refundable R&D tax offset. Where these refundable credits will no longer meet the loan repayment schedule (due to value or timing), this is likely to cause undue financial strain on many of Australia's small-medium R&D enterprises.

The second impact is in respect of R&D spend budgets for the 2020/21 fiscal year which have likely been significantly reduced due to the economic impacts from COVID19 and would likely be further reduced if the Bill is applied retroactively. Small-medium enterprises will require additional financial support due to COVID19 and losing access to previously budgeted refundable R&D tax offsets will further reduce their ability to invest in needed innovation within Australia.

We see research and development as fundamental to furthering Australian innovation and to growing the Australian economy, especially post-COVID. In this continually evolving COVID crisis, the incentive is more important than ever to the recovery of the Australian economy.

Rather than cut back on the RDTI, we believe that there are several immediate, interim measures which the Government can and should take to stimulate the growth of the innovation economy, including:

1. Applying any changes prospectively from 1 July 2021 or later and instituting a temporary moratorium on clawbacks
2. Paying quarterly refundable R&D tax offsets to support further R&D activities
3. Providing a one-time stimulus to eligible small entities using the RDTI as a vehicle

In the medium term, we propose that the RDTI scheme address the technology sector's concerns around qualifying software development activity and that the level of R&D support be increased with reference to the higher tax incentives available in other OECD countries.

While we appreciate that these investments will come at an expense, we propose them with the firm belief that the innovation economy, including the technology sector, will continue to drive the future of Australia's prosperity. We note with encouragement recent COVID-responsive stimulus efforts by the Government across several important sectors. An improvement to the RDTI would be a timely step for a stimulus targeted at the innovation and technology sectors of the economy.

We thank you for the opportunity to contribute and look forward to working with the Government to ensure that the RDTI continues to stimulate Australian innovation and a thriving technology and start-up ecosystem.

Yours sincerely

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