



22 January 2014

Senate Economics Legislation Committee
PO Box 6100
Parliament House
CANBERRA ACT 2600

Email: economics.sen@aph.gov.au

Committee Secretary

Inquiry into Tax Laws Amendment (Research and Development) Bill 2013

The Minerals Council of Australia (MCA) welcomes the opportunity to comment on the *Tax Laws Amendment (Research and Development) Bill 2013* (the bill).

The MCA is the peak industry organisation representing Australia's exploration, mining and minerals processing industry, nationally and internationally. MCA member companies produce more than 85 per cent of the nation's annual minerals output and 90 per cent of mineral export earnings.

Mining (including oil and gas) is a major contributor to investment in research and development (R&D) in Australia. Mining R&D expenditure was \$4.1 billion in 2011-12 (22 per cent of total business R&D expenditure), the second largest industry share behind manufacturing.

The bill limits access to the Research and Development (R&D) Tax Incentive to companies with assessable income below \$20 billion. The minerals industry is of the view that this:

- reduces Australia's competitiveness to attract R&D business investment;
- introduces unnecessary complexity into the R&D Tax Incentive; and
- underestimates the economic impact of R&D expenditure by large companies and multinationals in Australia.

The bill constitutes a change to the R&D Tax Incentive in only its second year of operation creating uncertainty as to Australia's commitment to tax incentives to support innovation. No compelling case to deny the R&D Tax Incentive to large companies has been articulated and no assessment appears to have been made of the impact on innovation or the economy.

Policy principle

The policy objective of the R&D Tax Incentive is to encourage investment in R&D in Australia given the positive economic spill overs that stem from innovation. As a global centre of mining production, research and innovation, Australia needs competitive, stable tax arrangements to incentivise investment in R&D. By denying R&D incentives to large companies, the bill does the opposite.

Importance of innovation in the mining sector

Australia is regarded as being at the forefront of harnessing new mining technologies. The minerals industry is a significant investor in R&D in Australia and has a good track record of commercialising its technological developments.

The mining industry's R&D activities aim to improve the competitiveness of the sector through continual advancement in exploration, mining and processing technologies (including information and communications technologies, remote sensing, satellite imagery etc). Mining and processing R&D has spill over effects to other industries including environment and rehabilitation applications, manufacturing, and construction. In addition, Australian exports of mining equipment, technology and services (METS) are estimated to be worth \$12 billion creating jobs beyond mining but also in manufacturing and service industries.

Consequences of the Bill

Uncertainty and Australia's competitiveness to attract R&D

The bill introduces uncertainty and undermines Australia's competitiveness as a place to undertake R&D, particularly multinationals.

The stated rationale for denying the tax incentive for large corporates is, according to the Parliamentary Secretary to the Treasurer, Steven Ciobo, that "The measure targets access to the research and development (R&D) tax incentive to the small and medium sized entities that are more responsive to increasing their R&D spending as a result of government incentives." No compelling case has ever been outlined that denying the R&D Incentive to large companies is warranted or that there is a greater innovation impact by providing incentives only to small and medium companies.

R&D tax incentives have been a long standing feature of Australia's tax system to encourage business, including large business, to invest in innovation. Competitor countries also recognise the importance of R&D by providing tax incentives to encourage and attract innovation investment given the positive spill over benefits.

The benefits of R&D were outlined in *Powering Ideas: An Innovation Agenda for the 21st Century* (the report) commissioned by the former Government and completed in May 2009. The report informed the design of the R&D Tax Incentive which came into effect in July 2011. The report acknowledged the importance of larger companies investing in R&D and the importance of maintain Australia's tax competitiveness:

"We also know that larger firms are critical to Australia's innovation effort; 70 per cent of our business R&D is done by firms with 200 or more employees, and we can't afford to see this capacity compromised. Finally, we know that more and more international firms are outsourcing their innovation activities to whichever location they believe is best equipped to support them. This has created fierce competition between knowledge-producing countries to attract foreign R&D investment."

By denying the incentive to large companies the bill moves Australia's R&D Tax Incentive out of alignment with competitor countries. No other R&D incentive program in the world has a large corporate exclusion. The bill discourages R&D spending in Australia by large multinational companies which can move R&D effort to other jurisdictions.

The denial of R&D deductions for large corporations may have flow on impacts to collaborative R&D work. Large corporations engage specialised local entities and universities to perform R&D activities on their behalf. Reducing R&D tax incentives will, therefore, have a much wider impact on Australia's innovation effort by de-incentivising collaborative R&D which is performed between corporates and small to medium enterprises and Australian universities.

The bill also constitutes yet another change to Australia's R&D tax arrangements so soon after the introduction of the R&D Tax Incentive in 2011 which replaced the previous R&D tax concession. This further change creates

uncertainty for claimants and undermines the ability of tax incentive to encourage investment in R&D. The OECD Directorate for Science, Technology and Industry recently noted the importance of stability in R&D tax arrangements a policy brief stating:

“countries that have experienced a large number of R&D tax policy reversals, the impact of R&D tax credits on private R&D expenditure is greatly diminished. It is therefore important that governments do not repeatedly tinker with such policies to minimise policy uncertainty for firms.”

Retrospective application

Backdating the policy change to 1 July 2013 constitutes a retrospective change to the tax law. While the policy was first announced in February 2013 by the previous government, there was no indication by the Coalition that this policy would be adopted until an announcement in November 2013. Companies that undertook R&D spending in good faith on existing law prior to announcement will be unfairly impacted. Large multinationals that focus the majority of their R&D spend in Australia will be particularly affected. Such an outcome hardly fosters confidence in multinational companies to undertake their R&D in Australia.

Complexity

The bill introduces a third tier to access the R&D Tax Incentive based on entity size. To further complicate matters, different concepts to determine entity size would also be introduced by the bill. The bill would result in:

- a 45 per cent refundable tax offset for small to medium entities ('aggregated turnover' of less than \$20 million per annum);
- a non-refundable 40 per cent tax offset for larger entities ('aggregated turnover' of more than \$20 million but 'aggregated assessable income' is less than \$20 billion); and
- no tax offset for entities with 'aggregated assessable income' over \$20 billion.

The bill introduces the concept of 'aggregated assessable income' which is not currently used in the R&D Tax Incentive. 'Aggregated turnover' is used to determine eligibility to the tax incentive. The two concepts include different amounts with 'aggregated assessable income' including more items of income such as statutory income and amounts from affiliates. This makes it easier for an entity to breach the \$20 billion threshold and become ineligible from claiming the R&D Tax Incentive. Introducing a new concept into the R&D Tax Incentive will also increase compliance costs for business which will have to determine affiliates and connect entity amounts to determine eligibility for the incentive.

While the bill would mean entities with 'aggregated assessable income' over \$20 billion would be ineligible for the tax incentive, they may claim deductions for R&D expenditure under other tax deductibility provisions. However, utilising some of the deductibility provisions may result in denial of an immediate deduction for some R&D expenditure. R&D spending on intangible assets, for example, would be depreciated over a period of time as a capital asset rather than being immediately deductible in the year the expenditure took place, thereby further discouraging R&D investment in Australia.

Recommendation

While no cost/benefit analysis has been provided of the changes outlined this bill, the cost to Australia's economy of reducing incentives for innovation, including longer term impacts of such as competitiveness and productivity, will likely far outweigh the short term revenue gain of \$1.1 billion.

The minerals industry therefore recommends that the bill be withdrawn and any changes to eligibility for the R&D Tax Incentive be considered as part of the government's planned review of the R&D Tax Incentive and as part of the White Paper on tax reform. Any changes to the R&D tax Incentive should be informed by proper analysis and these tax reform processes, which are welcomed by the MCA, offer the opportunity to consider ways to improve incentives for investment in innovation and R&D.

The MCA appreciates the opportunity to provide these comments to the Committee. Should you require any further explanation of the issues raised in this submission, please contact me

Yours Sincerely

James Sorahan
Director - Taxation