Senate Economics Legislation Committee Hearings – Questions on Notice 16 November 2018

Questions to Treasury:

Is there any other jurisdiction that utilises this measure [intensity measure] in the same way that we are proposing to do here?

Is that how intensity is measured internationally? Do you know?

Whether it's [intensity measure] an all-encompassing measure or whether it's an opt-in

Treasury Response: Any comparison of R&D tax incentives across countries is problematic. Companies take into account a number of factors when considering where to undertake their R&D, including the regulatory environment, access to a skilled workforce etc. A country's tax environment is only one element companies consider.

Details on R&D tax incentives can be found in the OECD *Compendium of R&D Tax Incentive Schemes: OECD Countries and Selected Economics, 2017.* The report notes that South Korea and Japan have intensity components in calculating the rate of support for large companies.

Question to DIIS: I imagine that in your consultations you would have run into organisations or industry bodies that would benefit from the changes to the R&D tax incentive scheme. Perhaps you might encourage them to let the committee know who they are.

DIIS Response: A number of companies are expected to benefit from the changes to the program, specifically those with higher R&D intensities. The department has encouraged a number of these companies claiming to be beneficiaries of the reforms, to identify themselves to the Committee.

Question to Treasury: Can you tell me when this report from the OECD became available to the committee working on the FFF report?

Treasury Response: The report in question was made available to the Review panel in March 2016 as a draft working paper under the title "R&D Tax Incentives: Design and Evidence". This draft working paper is referenced on page 30 in the 2016 Review report.

Question to DIIS: So, even though it's a prospective bill, it does in fact have a retrospective effect. Nobody brought that up during the consultation period?

DIIS Response: As part of the consultation process on the draft legislation undertaken between 29 June 2018 and 26 July 2018, a small number of submissions raised potential retrospectivity as a concern with the reforms.

It is important to note, however, that as claimants only register R&D up to 10 months following the end of the income year in which the R&D was conducted, there is limited potential for retrospective effect.

<u>Question to Treasury</u>: Who came up with this bill's title? Was it the Treasurer's office?

<u>Treasury Response</u>: The packaging of measures and the naming of Bills is a matter for Government.

<u>Question to Treasury:</u> Have you done any modelling on the impact of the changes that are in this bill on what will be the changes in expenditure? Can you provide that modelling to the committee? Can you provide your judgements to the committee?

<u>Treasury Response</u>: In constructing our estimate, we took as a starting point the finding of the Review of the R&D Tax Incentive that "around 10 to 20 percent of the total R&D registered would not be undertaken in the absence of the programme"; that is, in a system where an ordinary tax deduction would be received for R&D expenditure.

This implies that at least 80 to 90 per cent of total R&D registered will be undertaken under both systems, and our estimates reflect this.

For the remainder, the behavioural response will depend on both the change in incentives on the existing expenditure, as well as the incentive provided to undertake additional R&D expenditures through higher rates of support for incremental R&D.

There are three situations that arise under the proposed R&DTI that were considered:

- The marginal benefit of the R&DTI is less than the current system, but is still above the value of a tax deduction and high enough such that previous R&D expenditure is still undertaken.
- The marginal benefit of the R&DTI is less than the current system and results in less R&D expenditure undertaken.
- The marginal benefit of the R&DTI is more than the current system and results in greater or equal R&D expenditure undertaken.

It is not possible to directly observe from tax data the likely behavioural response. Treasury's assessment was that the behavioural impacts of those increasing and decreasing R&D expenditure would broadly offset each other. This assessment was based on analysis of the distribution of companies with R&DTI claims as well as other analysis provided by the Review.