pwc

The Secretary
Senate Economics Legislation Committee, SG. 64
PO Box 6100
Parliament House
CANBERRA ACT 2600

By email – economics.sen@aph.gov.au

22 January 2014

Dear Sir

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

PricewaterhouseCoopers (PwC) appreciates the opportunity to provide input to the Senate Standing Committee on Economics' inquiry into the *Tax Laws Amendment (Research and Development) Bill 2013* ("the Bill"), which, as drafted, will deny access to the research and development tax incentive for companies with aggregated assessable income of $20 billion or more for an income year.

While PwC acknowledges the Government's support of the R&D Tax Incentive and the policy intent of the Bill, we are concerned this change is potentially damaging to Australia's economy, primarily because:

1. Recent evidence points to the importance of innovation to competitiveness, employment and economic growth and positive correlation between R&D tax incentives and a country's ability to attract and retain innovative organisations

2. Any proposed changes are premature. A review of the new program is scheduled for this year and should be conducted with adequate data and consultation prior to proceeding with any changes, and

3. There are also likely to be a number of unintended consequences of the Bill.

Further detail is attached.

Yours sincerely

Charmaine Chalmers
Partner – R&D Incentives

PricewaterhouseCoopers, ABN 52 780 433 757
Riverside Centre, 123 Eagle Street, BRISBANE QLD 4000, GPO Box 150, BRISBANE QLD 4001
T: +61 7 3257 5000, F: +61 7 3257 5999, www.pwc.com.au

Tax Laws Amendment (Research and Development) Bill 2013
PwC submission to Senate Economics Legislation Committee

1. Linkages between R&D tax incentives and economic growth

In response to current budgetary pressures, limiting access to the R&D Tax Incentive may seem like a logical savings measure. We are concerned the converse is true.

The OECD has repeatedly made the link between innovating and economic growth:

> *Undoubtedly the capability to innovate and to bring innovation successfully to market will be a crucial determinant of the global competitiveness of nations over the coming decade. There is growing awareness among policymakers that innovative activity is the main driver of economic progress and well-being as well as a potential factor in meeting global challenges in domains such as the environment and health.*[1]

This is supported by Thomson Reuters Top 100 Innovators Report, October 2013, which showed the most innovative companies grew revenue (taxable income) faster and created more jobs (than others in the S&P500).

> *Collectively, the 100 organizations in our 2013 study outperformed the S&P 500 by 4 percent in annual stock price growth and 2 percent in market cap weighted revenue growth. These organizations generated more than $4.5 trillion in annual revenue, nearly twice the GDP of the United Kingdom. The Top Innovators also added 266,152 new jobs over the course of the year, 0.81 percent higher than the new job creation rate among constituents of the S&P 500. And, this year's winners outspent the S&P 500 by 8.8 percent on R&D.*[2]

This report also confirms the link between R&D tax incentives and the retention of innovative organisations.

> *There is a direct correlation between a government's commitment to innovation and its R&D tax policies to its ability to attract and retain innovative organizations.*[3]

We are concerned that these measures remove the incentive for Australia's largest innovators to continue to conduct R&D and/or continue to conduct R&D in Australia and the implications this may have for our economic growth and tax revenues. This is especially concerning as companies impacted are likely to have highly mobile capital and existing infrastructure to respond to changing incentives and have the ability to move operations offshore.

We are also concerned about further impediments to investment and the impact on the economic transition occurring in the Australian economy.

---

[1] OECD, Innovation and Growth - Rationale for an Innovation Strategy, 2007
[2] Thomson Reuters 2013, Top 100 Global Innovators, October 2013
[3] Thomson Reuters 2013, Top 100 Global Innovators, October 2013

pwc

As referred to in in the Mid-Year Economic and Fiscal Outlook released in December 2013:

> *The Australian economy is expected to transition from resources to non-resources drivers of growth. But this transition is likely to be slower than previously forecast*[4].

Given investment in the resources sector is forecast to detract from economic growth from 2014-15, removing R&D incentives could weigh heavily on investment decisions from firms in both the resources and non-resources sectors of the economy.

A further deterioration in investment would lower economic growth and could further hinder the transition to non-resources drivers of growth.

Australia is facing fundamental challenges in maintaining prosperity into the future. Tax reform is the most comprehensive way of addressing these issues. And if we do it the right way – by ensuring we lift only those taxes that have the least effect on economic growth, reduce our reliance on taxes that are damaging– then tax reform can also help us drive productivity growth, encourage investment and lift real incomes per person.

PwC supports a properly designed tax system with the right mix of taxes to balance the objectives of equity, efficiency and adequacy. PwC's thought leadership work on "Protecting prosperity: why we need to talk about tax", expands on this further. Available on line at: http://www.pwc.com.au/tax/tax-reform/.

2. Changes are premature prior to a review

Within the EM, the Government has re-affirmed a commitment to undertake a comprehensive review of the new R&D Tax Incentive program during 2014.

In light of this planned review, it seems incongruous that this Bill, which will dramatically affect some of Australia's largest and most successful companies, be brought to Parliament now, without the benefit of a complete and fully considered review with adequate data on the cost to revenue.

The new program introduced various "limiting" measures, such as the removal of the 175% Incremental Premium Concession and the introduction of the "Dominant Purpose" test for supporting R&D activities – the impact of these needs to be properly assessed before further limitations are contemplated. We are concerned about the impact on the confidence business can have in the predictability of the incentive, even for those not impacted.

If the review concludes there is need for change(s) to the program, this process would also allow alternatives to be explored in consultation with stakeholders, such as a cap on the benefit available to large companies.

[4] Mid-Year Economic and Fiscal Outlook 2013-14 – released 17 December 2013

pwc

3. *Unintended Consequences*

- *Australian companies disadvantaged by the use of "assessable income" to test the $20 billion threshold*

"Assessable income" has its meaning from standard tax provisions, and includes ordinary income and statutory income. In general terms, it is the amount on which a business is subject to Australian income tax before considering deductions. In summary:

- Australian residents include worldwide ordinary and statutory income in their assessable income;
- Foreign residents include only Australian-sourced ordinary and statutory income.

As drafted, the Bill has the potential to deny large Australian businesses (including some of our largest exporters and employers) access to the program, while continuing to provide Government assistance to foreign inbound businesses (with potentially larger Australian operations).

- *Effect on BERD*

Business expenditure on research and development (BERD) is an important measure of innovation in the economy and is often used to measure our innovation performance against other OECD nations.

In Australia, historical changes in BERD have been correlated to changes in the former R&D Tax Concession. In general, Australia's BERD has positively correlated to the broad "generosity" of the available tax incentives. This is consistent with the findings of Thomson Reuters above, but an unintended impact of the Bill may be the elimination of any incentive to rigorously measure R&D for reporting by these large companies. This will have an impact for the BERD Australia reports and the meaningfulness of our BERD data.