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Senate Standing Committees on Economics
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Our ref Tax and Superannuation Laws Amendment Bill (No5) 2014

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Dear Secretariat

Tax and Superannuation Laws Amendment (2014 Measures No. 5) Bill 2014

Thank you for the opportunity to comment on the Tax and Superannuation Laws Amendment (2014 Measures No. 5) Bill 2014. Whilst there are a number of matters covered in this Bill, we have restricted our comments to the proposed reduction in the R&D tax incentive offset rate in Schedule 3.

In tabling this Bill, the Government stated that “these changes are in line with the Government's commitment to cutting the company tax rate by 1.5 percentage points from 1 July 2015”. It appears illogical to reduce the incentive rate prior to the corporate tax rate if the intention is to keep the rate in line with each other.

Moreover, making the incentive rate reduction prior to changing the corporate tax rate causes a number of other R&D adjustments to no longer operate as they were intended. This will result in situations where companies actually pay more tax when they undertake R&D than if they had not conducted R&D.

When the R&D tax incentive was first introduced, it was the Governments’ intention that providing a tax offset rather than a deduction would mean that changes in the corporate tax rate would not impact the R&D incentive. That is, companies had the certainty that they would continue to get a 40% or 45% offset regardless of the corporate tax rate. Not only is the Government reconnecting the offset rate with the corporate tax rate, it is reducing the benefit first and then potentially reducing the corporate tax rate.

Impact on R&D adjustments

Under the current R&D tax incentive provisions there are two adjustments which effect the level of benefit received by a company: feedstock and government recoupments. Each of these adjustments has a separate mechanism, however both currently result in a 10% reduction of the benefit for affected R&D expenditure. The 10% reduction is to essentially remove the difference between the 40% offset and the current corporate tax rate of 30%.

These adjustments will require amendment for the 2015 year and then will need to be amended again, back to the current position, when/if the corporate tax rate is reduced. If the adjustments are not amended an R&D entity will be penalised for undertaking R&D activities and will pay additional income tax instead of receiving an incentive.

For example a company receiving a government grant will pay 10% additional tax to eliminate the 8.5% extra offset it received (38.5% - 30%). Therefore it will pay 1.5% for the privilege of doing R&D and receiving a grant.

The feedstock adjustment produces the same result, 1.5% additional tax, by more complex calculations.

Each of these adjustments can also be impacted by the timing of the expenditure compared with the timing of the adjustment as these can occur in different income years. Given this increased level of complexity, the most sensible approach would be make any reduction to the R&D offset rate at the same time as the reduction in the corporate tax rate. This would potentially also avoid the need for further amendments to these adjustments when the corporate tax rate is reduced.

Uncertainty

The rate reduction limits companies' ability to plan their long term R&D investments. Many companies made decisions about their 2015 R&D investments prior to the Budget announcement in May 2014. This can be demonstrated by the number of companies who have obtained Advanced Findings from Innovation Australia in respect of the 2015 year. These companies made decisions with the knowledge that the offset rates were 40% or 45%. As the R&D tax incentive program only commenced in 2011, after lengthy consultation, it would have been reasonable to these companies that there would be a period of stability for the R&D tax incentive.

And this is no small change to the offset rate. Effectively this is a 15% change to the 40% offset rate and a 10% change to the 45% offset rate. This level of change has a significant impact on a company's ability to continue effectively its R&D program and potentially R&D spend has already been committed.

This is yet another example of a suite of proposed changes to R&D Tax Incentive (rate reduction, $20 billion exclusion, quarterly credits proposed then removed) which all destabilise the R&D incentive landscape in Australia.

Innovation to be nurtured needs to have certainty as to the treatment being offered. Tax incentives are an important element of the decision to locate R&D in a jurisdiction and has spill over benefits. Through its conduct, the Government is actively dissuading companies from doing R&D in Australia.

We strongly believe that a cornerstone objective of Australia's R&D incentive should be to encourage R&D activities within Australia in order to, amongst other things, make eligible enterprises internationally competitive. Reducing the benefit, even if temporarily, is likely to have an adverse impact on encouraging investment in R&D in Australia. We note that in today's global community, companies can choose to undertake all or part of their R&D in jurisdictions that are cheaper or provide greater incentives. Whilst the rest of the world, such as the United

Kingdom, looks to attract more investment in R&D to its shores, we continue our misguided focus on R&D as a cost rather than an investment.

The object of the R&D Tax Incentive is, in part, to support R&D likely to produce net-benefits for the Australian community. As the majority of R&D must be undertaken in Australia to qualify for the incentive, the R&D incentive directly encourages increased employment and use of Australia companies and research facilities, benefitting and fostering the Australian community. If successful, R&D will result in innovative products and services that compete globally and benefit the wider Australian economy.

We question the rationale for the proposed reduction as not only is it decoupled from the proposed company tax rate reduction, it immediately precedes a tax white paper, serving to generate unwarranted confusion, uncertainty and unpredictability in the government's approach to taxation. Support for innovation is being undermined in advance of any consultation.

We hope the Committee considers seriously the impact of the proposed reduction both on companies doing R&D and on the wider community that R&D supports and promotes. We urge the Committee to recommend that if a rate reduction is required that it be paired with the company tax rate reduction and that this legislation in its current form does not become law.

Yours faithfully

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