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

economics.sen@aph.gov.au

To the Senate Standing Committee on Economics

Submission – Treasury Laws Amendment (Research and Development Tax Incentive) Bill 2019

As a long-standing participant in the R&D Tax Incentive program, Telstra welcomes the opportunity to contribute our views on the *Treasury Laws Amendment (Research and Development Tax Incentive) Bill 2019* (the Bill).

Since the release of the 2016 Review of the R&D Tax Incentive Report, followed by the announcement of the proposed R&D intensity measures in the May 2018 Federal Budget, Telstra has expressed its concerns with the proposed R&D intensity measures. These views have been outlined in earlier submissions to departments, input into industry body submissions, and contributions to various roundtables and consultation processes.

As acknowledged in the R&D Tax Incentive Report, undertaking R&D activities is, by its very nature, labour intensive, costly and risky. The R&D tax incentive reduces the costs of business undertaking R&D activities. Cost is critical to determining whether the R&D will be undertaken and where it will be undertaken.

Telstra considers the changes proposed in the Bill will reduce the incentive to undertake R&D activities in Australia and consequently reduce current and future national R&D activities. Economic studies have demonstrated that spending through an R&D tax incentive drives growth. The short-term reduced cost to the revenue of limiting the incentive, without any other R&D investment in the program, will potentially lead to lower economic growth over the long term, and reduce the likelihood of Australia achieving its innovation objectives.

Why a strong R&D program is so important to Australia

Telstra strongly supports the R&D Tax Incentive as a means to encourage innovation and investment in Australia for the future prosperity of the country.

In 2016, the objective of the R&D Tax Incentive Review was to “improve the effectiveness and integrity of the R&D Tax Incentive, including by sharpening its focus on encouraging additionality and spillover from the R&D expenditure”.

In designing and implementing Australia’s R&D policy, we believe it is imperative to have regard to global trends in R&D investment and how other tax jurisdictions are supporting their country’s innovation agenda. With an increasingly global and agile workforce and with increasing R&D investment focused on digitisation and automation across all industries, it is critical that Australia is internationally competitive in our R&D policy to attract/retain investment and the spillover effects which promote productivity, entrepreneurship and economic growth.

The 2020 Bloomberg Innovation Index (BII) shows Australia has fallen to 20th globally. Countries with smaller GDP than Australia, such as Israel and Finland, are ranked higher. While corporate tax rates and attractive foreign investment policies are indicators of innovation success, the existence and effectiveness of R&D tax incentive policies is also critical. By way of example, a number of countries ranked in the BII top ten have extensive and more generous R&D tax incentives than Australia. For example, Singapore offers super deductions of up to 250 percent for certain qualifying expenditure, and our close neighbour New Zealand offers a 15 percent tax credit.

Impact of the Bill on Telstra

Telstra's purpose is to build a connected future so everyone can thrive, and we have a strong track record in innovation. Due to our capabilities, insights and initiatives we are global leaders in this area. We partner with customers, technology partners, suppliers, governments and community organisations on technology and innovation.

We support innovation in numerous ways, including through traditional R&D projects, our Customer Insights Centres and Telstra Labs, which is home to Australia's first publicly-accessible Internet of Things (IoT) Lab, designed to build a community around IoT product design.

We are also committed to working with the Government and industry to create a strong innovation ecosystem, building a technology talent pipeline domestically through a combination of skilled immigration, STEM (science, technology, engineering and mathematics) education policies, and innovation and R&D policies.

However, since the introduction of the current R&D Tax Incentive, Telstra has faced reductions and uncertainty in relation to the operation of the program. The initial 10 percent net benefit was reduced to 8.5 percent in FY17 and the Bill proposes to further reduce that benefit by almost half to 4.5 percent.

We believe if the Bill is passed in its current form it could result in discouraging additional R&D expenditure in Australia for many claimants (particularly large businesses).

Telstra's concerns with the Bill relate to two primary issues:

- the proposal to implement an unyielding intensity measure based on qualifying R&D expenditure as a percentage of total accounting operating expenditure; and,
- a cap level of \$150 million, which for Telstra will mean we will be permanently ineligible for any net benefit beyond the first tier (4.5 percent net benefit) due to our high Australian cost base.

The intensity measure punishes claimants who have an inherently high Australian cost base, such as the telecommunications industry, which is capital intense and has a large Australian employee base. This capital intensity is borne out in the fact that the telecommunications industry had the second highest investment rate in the Australian economy, with 70.5 percent of total industry value added invested in 2017-18 (approximately \$18.3 billion). This measure highlights that the industry allocates a significant amount of resources to improving existing infrastructure, research and deployment of new technology to the market.¹ The intensity measure therefore has the effect of penalising the telecommunication industry's high investment in infrastructure, which is critical to Australia's economy and society. It also provides a relative competitive advantage to foreign multinationals who have a low Australian cost base.

The proposed intensity measure introduces a three-tiered incentive designed to encourage R&D expenditure, with the top tier having a generous "headline" rate of 12.5 percent. However, the imposition of a \$150M cap ensures that businesses with expenses greater than \$3.75 billion can never get beyond the first tier (4.5 percent net benefit) regardless of how much we actually spend on eligible R&D activities. Further, even if a business has sufficient intensity expenditure to progress beyond the first tier, unabated by the cap, only the incremental expenditure benefits from the higher rates provided in the upper tiers. This would undermine the current approach in which, in many cases, large Australian corporates undertake R&D work that is not viable for smaller corporates, e.g. by connecting numerous parties to collaborate for a scalable and national solution.

While the R&D Tax Incentive is not the sole motivator to undertake R&D activities, it does influence our decision to undertake the R&D activities in Australia. The proposed intensity measure would increase our after-tax cost of conducting R&D and consequently, we would need to make choices between reducing overall R&D spend or maintaining/increasing the R&D spend at the expense of other elements of operational expenditure, such as network performance.

¹ Deloitte Access Economics, *Connected Nation*, 2019. Available at <https://www2.deloitte.com/au/en/pages/economics/articles/connected-nation.html>.

While we are disappointed the Bill as introduced in this Parliament has not been amended to reflect the recommendations made by the Senate Economics Legislation Committee in February 2019, we welcome the opportunity for the Parliament to consider these issues again. We strongly recommend the Committee consider how the Bill could be amended to strengthen the effectiveness and integrity of the R&D Tax Incentive.

Yours sincerely,



Ben Guthleben
Taxation Executive