

R&D Tax Incentive Review Secretariat  
GPO Box 9839  
Canberra ACT 2601  
Delivered via email: *R&DTaxIncentiveReview@industry.gov.au*

29 February 2016

Dear Sir/Madam

Swanson Reed  
ABN 72 137 072 701

[REDACTED]

[REDACTED]  
www.swansonreed.com.au

**Submission: R&D Tax Incentive Review**

Please find enclosed our submission to the review of the R&D Tax Incentive instigated as part of the National Innovation and Science Agenda.

Swanson Reed has previously emphasised the important role of the R&D Tax Incentive for encouraging investment in R&D Activities within submissions to previous consultations:

- 2015 Tax White Paper (Re:Think);
- 2014 Senate Inquiry into Australia’s Innovation System.

The content of this submission is focussed specifically on items within the review’s scope document and accompanying issues paper.

**About Swanson Reed**

Swanson Reed is a leading specialist R&D Tax Advisor that services a wide spectrum of clients in various locations throughout Australia.

In addition to chartered accountants, Swanson Reed’s team includes technical personnel with backgrounds in engineering, science and law.

Since its introduction in May 2009, Swanson Reed has conducted over 250 workshops on the R&D Tax Incentive and Concession. The workshops have identified that many small and medium-sized enterprises (SMEs) are of the view that the programme will be subject to further cuts in future, which reduces the willingness of SMEs to invest in R&D and innovation.

Swanson Reed is of the view that stable and generous support for R&D must be maintained to give companies confidence to invest in long term innovation strategies. This will also have spill over benefits for Australia as our economy transitions from being resource driven to knowledge driven

## Summary of Findings and Recommendations

- A long-term commitment to the stability of the R&D Tax Incentive is the single measure most able to enhance the effectiveness of the programme.
- A dedicated 'R&D Tax Agent' qualification may enhance integrity, control cost and provide AusIndustry/ATO a dedicated platform to communicate programme updates and professional expectations.
- Companies use the R&D Tax Incentive not as a means of systematic tax planning or annual minimisation, but rather as a means of support during specific phases of investment in R&D Activity. The R&D Tax Incentive also plays a key role in SMEs' decision of whether to invest in R&D or conduct additional R&D Activities.
- Claimants generally understand the policy intent behind the scope and definition of eligible activities introduced as part of the R&D Tax Incentive in FY12. This scope and definition should remain unchanged.
- The proposed 1.5% uniform reduction in R&D Tax Offset rates within *Tax and Superannuation Laws Amendment (2015 Measures No.3) Bill 2015* should be amended such that the reduction only applies for 'Small Business Companies' who now qualify for a corresponding 1.5% reduction in corporate tax rate. Otherwise, the uniform reduction represents a cut to the permanent benefit of the programme and reduces its stability and ability to encourage future investment in R&D.
- The threshold settings of the R&D Tax Incentive are generally well calibrated and function to uphold the programme's intent of targeting support to entities most responsive. A periodic adjustment to the turnover threshold for refundable R&D Tax Offsets should be considered every 5 years as this would, in real terms target refundability access to the scope of entities intended at the outset of programme introduction in FY12.
- Implementing a 'pre-registration' requirement may enhance the additionality of the programme; however, such a change would exponentially increase complexity, cost and administrative burden to participants. It is already well understood that participants in the programme must thoroughly document activities from their outset and the current logistical arrangements for registration 10-months after financial year end should remain.
- A single agency administration model may provide efficiency, transparency and participant service benefits. If this were to be explored, AusIndustry should be the primary administrator and split into two distinct teams:
  - 'R&D Activity Compliance team' fulfilling same function already served by current customer service managers;
  - 'R&D Expenditure Compliance team' featuring R&D Tax experienced staff deployed from ATO and fulfilling function of current ATO Innovation tax staff.
- The R&D Tax Incentive should remain a broad-based programme administered through the tax system. A move to a grant based, competitive system would drastically reduce the effectiveness and attractiveness of the programme.
- An enhanced rate of R&D Tax Offset for expenditure incurred from RSPs or Universities could generate greater instances of collaboration. Restrictions to claims for classifications of R&D Expenditure less likely to generate spill over could be made to offset the cost of any enhanced rate for RSP expenditure.
- It remains crucial that Australia's R&D Tax Incentive remains competitive and stable to allow global companies to have the confidence to invest in Australian R&D. The absence of an

Australian patent box type-incentive further emphasises the importance of the programme in attracting global investment.

- The cost of the R&D Tax Incentive appears to be significantly overstated within the Issues Paper. Budget recording of the R&D Tax Incentive must measure the true cost and benefits of the programme, incorporating both,
  - Timing adjustments arising from the programme's design of supporting phases of investment in R&D at companies' expense of forgone tax losses; and
  - Spill overs from investment in the activities, which the R&D Tax Incentive supports.
- The R&D Tax Incentive appears to be meeting ease of access objectives given the steady increase in the number of registrations. AusIndustry services have performed well in assisting participants understand the nature of eligible activities. The ATO should be afforded sufficient resourcing to reintroduce the Innovation Tax Support service which was highly useful when in operation.

### **Format of Detailed Submission**

The scope document for the current review outlines several key focuses which have been addressed in sequence:

1. *How could the R&D Tax Incentive programme be improved?*
  - a. *For greater effectiveness;*
  - b. *For greater integrity;*
  - c. *To better prompt additional R&D activity.*
2. *In particular, are there aspects of the definition of what is and is not R&D, the rates and thresholds, the programme design and/or administrative processes that could be improved?*
3. *What is the role of the R&D Tax Incentive in pursuing other objectives, such as international tax competitiveness and collaboration with publicly-funded research bodies?*
4. *How does it compare with international practice around support for business R&D?*
5. *What is the historical and projected cost of the R&D Tax Incentive? What drives the costs?*
6. *How could the R&D Tax Incentive be made easier for participants to understand and access?*

### **How could the R&D Tax Incentive programme be improved for greater effectiveness?**

Within the summary of previous stakeholder feedback available on the R&D Tax Incentive Review website, there was an overwhelming view that stakeholders were pleased with the programme and were clearly in favour of continuing and improving it.

Swanson Reed's view is that the programme remains crucial for Australia's transition to a knowledge based economy, and that maintaining a long term commitment to the programme's stability is the single best way to enhance its effectiveness.

Since the relatively recent introduction of the R&D Tax Incentive in FY12, the programme has been subject to a number of proposed changes:

- *Proposed legislation not passed by Senate:* a proposal to allow companies to receive quarterly refunds of their entitlements was not passed as law.

- *Proposed legislation not passed by Senate:* a proposal to remove access to the R&D tax incentive for very large companies with turnover greater than \$20 Billion was not passed. This cut to the programme for large claimants was later restructured and introduced in an amended form.
- *Enacted legislation passed through Senate:* from 1 July 2014 for FY15, a cap of \$100 Million has been placed on the R&D Tax Incentive to limit the eligible expenditure of large claimants; and
- *Proposed legislation stalled in Senate:* from 1 July 2014 for FY15, it has been proposed that a uniform 1.5% decrease will apply to the rate of R&D tax offsets.

The series of changes proposed to the programme reduce companies' willingness to invest in R&D activities in the expectation that the legislated entitlement will remain. Any adverse changes also harm Australia's reputation as a destination for investment in R&D, as many overseas entities have invested in Australia based on expected future entitlements available under the R&D Tax Incentive.

The OECD has also recently warned against R&D tax *policy reversals*:

*"For 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."*

Further, the OECD has suggested that stable government incentives increase innovation:

*"The available evidence shows that R&D tax incentives do increase business expenditure on R&D, with the effects typically being larger in the long run than in the short run. The evidence also suggests that smaller firms seem to be more responsive to the R&D tax incentive than larger firms, typically because these firms are much more credit-constrained. The stability of the R&D tax incentive scheme over times also plays an important role. Expectations that R&D incentives are permanent strengthen their impact on R&D investment."*

A generous and certain programme will be the key to increase Australia's innovative capacity through encouraging companies to undertake R&D activities. However, companies need a stable legislative platform to provide them with the confidence to make long-term decisions in anticipation that support will be available.

A bipartisan commitment to the stability of the R&D Tax Incentive would give companies confidence to make long-term investments in R&D and may reduce concern of changes to R&D entitlements across future political and budgetary cycles.

### **How could the R&D Tax Incentive Programme be improved for greater integrity?**

Based on integrity assurance work to date, as noted in the Issues Paper, there is a relatively high level of compliance with the programme's eligibility requirements.

While we have become aware of some isolated exceptions, Swanson Reed largely concurs with this view and credits AusIndustry for their leadership in emphasising the need for participants to use the programme responsibly as a means of ensuring sustainability.

Some options for further enhancing the integrity of the programme may include:

- Ensuring the ATO are equipped with the necessary resources to act promptly in the isolated cases where companies or advisors use the R&D Tax Incentive as part of tax promotion schemes;
- Creating a dedicated “R&D Tax Agent” qualification for specialist advisors or accountants providing R&D Tax Services. This would mandate specific professional and experience standards rendering them qualified to advise on the intricacies of the R&D Tax Incentive, in addition to the current standards under the general tax agent services legislation. Given that the growth of the programme has largely been attributed to marketing by advisors, such a qualification may ensure new entrants to the programme are receiving suitable advice on their entitlements. Such a qualification would also provide AusIndustry/ATO a dedicated platform to communicate programme updates and professional expectations;
- Requiring claimants to include a summary of the basis for R&D expenditure calculations within their R&D Schedules to allow the ATO greater transparency in identifying claims suitable for targeted compliance activity;
- Encourage self claimants to participate in AusIndustry compliance workshops or be subject to educational site visits to ensure integrity in the absence of an independent review;

### **How could the R&D Tax Incentive Programme be improved for greater additionality?**

Based on feedback from clients and stakeholders, Swanson Reed is of the view that the current R&D Tax Incentive provides a high level of encouragement for companies to undertake R&D activities they may not otherwise have conducted, particularly SMEs.

Of particular note, Swanson Reed has found companies upheld the policy intent of the programme and claimed specifically during phases of start-up or dedicated investment. Our surveys indicate that claimants in a given year have a 30-40% chance of not making a claim in the subsequent year. While Swanson Reed’s figures may be amplified given our focus in the SME sector, our survey results are somewhat supported by AusIndustry’s registration statistics as at February 2015, which indicated 1,200 new claimants, when the overall actual increase in claimants was only 850.

The cause of claimants exiting the programme varies, however some common reasons include:

- The company has failed altogether.
- The company has run out of capital to undertake R&D Activities and remains dormant whilst it tries to procure new sources of funding.
- The company does not have the confidence to invest in R&D Activities given current economic outlook and may be focusing solely on their core or incumbent businesses.
- The company has moved out of its R&D phase and is focused on commercialising its activities.
- Tax logistical issues such as exhaustion of tax losses or franking account constraints may mean that the company chooses not to pursue an R&D claim.

Despite the high rate of non-recurring claims, the vast majority of these companies have indicated to Swanson Reed:

- The R&D Incentive played a key role in their original conduct of R&D activities.
- The entitlements available under the R&D Tax Incentive would influence their future investment decisions for determining whether to again undertake R&D activities OR the amount they would invest in future R&D activities.
- If the company were to invest a material amount in future R&D activities, they again planned to access the programme.

Such results indicate that companies, particularly SMEs with high capital constraints, use the R&D Tax Incentive not as a means of systematic tax planning or annual minimisation, but rather as a means of funding or Co-Investment during specific phases of investment in R&D activity.

### **Are there aspects of the definition of what is and is not R&D that could be improved?**

Based on feedback from clients and stakeholders, we note that despite some claimant's initial difficulties conceptualising their activities in terms of a scientific method, companies are now generally comfortable with the scope and definition of eligible R&D activities within the current legislation.

Swanson Reed has observed that:

- Claimants generally understand the policy intent of encouraging companies to document their R&D Activities in a systematic and scientific manner.
- Claimants generally understanding the rationale for excluded core activities (market research, prospecting, etc.) as a means of suitably targeting the programme.
- Claimants have become comfortable with the current programme's emphasis on experimental activities, and there is a general understanding that eligibility of the core activities ceases once the technical uncertainty and hypothesis is resolved.
- Claimants understand the restrictions on supporting activities and the policy intent of limiting claims for "business as usual" costs, particularly those conducted in a commercial setting.

We accordingly, would not recommend any changes to the scope of eligible core R&D activities, since:

- Companies are now (relatively freshly) familiar with the established definition.
- In a number of cases, long-term investment decisions have been made based on the now established definition.

One potential area for improvement may be to remove the exclusion on internal administration software. Such a change may:

- Reduce the complexity of the programme and simplify compliance processes for AusIndustry assessors.
- Encourage companies to invest in internal software developments, which may have spill-over efficiency benefits for their business.

If the exclusion for internal administration were removed, a corresponding integrity provision may need to be introduced to ensure internal administration software claims are made only for the reasonable experimental phase of development.

### **Are there aspects of the rates and thresholds that could be improved?**

Previous Swanson Reed submissions have objected to the proposed 1.5% uniform reduction in the R&D Tax Offset rate currently before the senate within *Tax and Superannuation Laws Amendment (2015 Measures No.3) Bill 2015*.

Our objection is based on the fact that the original proposal for reduction in the R&D Tax Offset rate was linked to the uniform reduction in the corporate rate by a corresponding 1.5%.

As this proposed corporate tax rate reduction did not proceed as planned and will now only apply to small companies, the 1.5% uniform reduction in the R&D Tax Offset rate represents a permanent cut to the programme. Such a reduction compromises the stability of the programme and reduces its stability and ability to generate spill over.

Understanding the need for budget restraint, Swanson Reed would not be opposed to the proposed reduction in the R&D Tax Offset applying to companies qualifying for the small business corporate tax rate (28.5%). The impact of such a reduction in the R&D Tax offset for “small business companies” would mean:

- The permanent tax benefit of claims for such companies would be preserved at \$0.15;
- The Refundable R&D Tax Offset for such companies when in tax loss would reduce from \$0.45 to \$0.435; however, this reduction can be considered fairly immaterial and mitigated by the effect of the reduction in corporate tax rate.

In respect of threshold issues, there are three main thresholds relevant to the R&D Tax Incentive:

- \$20,000 minimum expenditure threshold;
- \$20M turnover threshold for access to the Refundable R&D Tax Offset;
- \$100M threshold capping annual expenditure.

Swanson Reed’s view, shaped by feedback from stakeholders is that the threshold settings of the R&D Tax Incentive are generally well calibrated and function to uphold the programme’s intent of targeting support to entities most responsive:

- The minimum expenditure threshold reduces processing burden for administrators by limiting very small claims.
- The turnover threshold provides a higher level of assistance to SMEs who are more needing and responsive to the refund ability of the R&D Tax Offset and higher level of Offset.
- The maximum expenditure threshold, while generally viewed as an adverse change to the stability of the programme, has been widely accepted as a necessary budget measure to ensure future sustainability of the program for the vast majority of claimants.

The one change to thresholds Swanson Reed would recommend is a periodic adjustment of the turnover threshold for access to the Refundable R&D Tax Offset, to adjust for the value of inflationary impacts. This may allow access to the refundable R&D Tax Offset for a company who was under the \$20M threshold in FY12 at the programme's inception, but now slightly in excess.

For simplicity, such adjustments to the turnover threshold for Refundable R&D Tax Offsets could be adjusted once every 5 years (e.g. threshold increases to \$23M in FY17 to reflect 3% inflation since FY12). This would in real terms target Refundable R&D Tax Offset access to the scope of entities intended at the outset of the programme's introduction in FY12.

**Are there aspects of the programme design and/or administrative processes that could be improved?**

Some changes to the programme design discussed within the Issues Paper are considered sequentially:

Introduction of a requirement for 'pre-registrations':

Within the Issues Paper, the idea of a 'pre-registration' requirement is cited as a potential means of increasing additionality and controlling cost of the programme.

Swanson Reed is of the view that such a change may enhance the additionality of the programme; however, it would exponentially increase complexity, cost and administrative burden to participants.

If a pre-registration requirement were to be introduced, a follow up R&D application after the financial year would still be necessary for integrity assurance purposes, requiring claimants to:

- Disclose the actual amount of R&D Expenditure incurred for the full financial year;
- Provide specific details of the nature of R&D Activities that were actually conducted by the company for the full financial year.

The requirement for two statutory submissions would likely substantially increase the compliance cost for both companies and regulators.

It is also important to note that the current R&D Incentive programme requires claimants to robustly document their activities upon commencement to be able to show the inception of an activity hypothesis and corresponding series of experiments. This requirement has been affirmed by a number of AAT decisions, which have been widely publicised.

It is already well understood that participants in the programme must thoroughly document activities from their outset and the current logistical arrangements for registration 10 months after financial year end should remain

If companies were required to formally submit such information to AusIndustry upon commencement of R&D Activities, it would unnecessarily increase programme complexity and compliance burden.



Introduction of a single agency for administration of the programme:

Within the Issues Paper, the idea of a single agency administrator is cited as a potential means of making the programme more efficient and enhancing integrity.

Since the implementation of the R&D Tax Incentive, AusIndustry has been the agency primarily responsible for education of stakeholders and roll out of the programme.

Swanson Reed commends the leadership of AusIndustry in doing so, as they have proactively engaged with stakeholders to encourage participation, while also emphasising the boundaries of eligible activities.

The ATO has been less visible and more compliance focused and this has likely been a function of ATO resourcing constraints and the recent restructure to disband the ATO Innovation Segment. We also note that the direct ATO support function for R&D Tax Matters (Innovation Tax Mailbox) has been gradually phased out, which is disappointing since our previous experience with this service was very positive.

Swanson Reed recognises the rationale for the administration by two government bodies given the distinct areas of compliance:

- Assessment of whether companies' R&D activities are eligible;
- Assessment of the reasonableness of companies' R&D expenditure along with a number of complex tax issues, including:
  - Assessment of the capital nature of expenditure;
  - Assessment of whether expenditure has been incurred and paid;
  - Determining entity grouping and associated threshold issues;
  - Adjustments for feedstock and clawback;
  - Determining whether activities are undertaken on behalf of the R&D entity.

Conducting compliance on such issues require differing professional backgrounds, hence distinct and separate compliance teams are likely to always be required.

Swanson Reed does, however, recognise that efficiency, transparency and participant service benefits may arise if all relevant compliance officers were within a single government agency.

While we are undecided on whether a single-agency model should be pursued, if this were to be considered, our proposal for the model would be something to the effect of:

- AusIndustry remains the primary administrator of the programme and responsible for participant education and governance.
- Companies are still required to register activities with AusIndustry and submit R&D Schedules within their company income tax returns.
- ATO staff with knowledge of R&D-specific tax issues are deployed to AusIndustry to form two separate teams:

- 'R&D Activity Compliance team' fulfilling same function already served by current customer service managers;
- 'R&D Expenditure Compliance team' fulfilling function of current ATO staff. This team should be given direct access to all claimant's R&D Schedules upon lodgement.
- AusIndustry 'R&D Activity Compliance team' conducts desk, activity and finding compliance reviews in the same format as currently operates.
- AusIndustry 'R&D Expenditure Compliance team' conduct compliance activity based on:
  - Issues identified during their own review of a companies' R&D Schedules;
  - Issues referred by AusIndustry 'R&D Activity Compliance team' rendering the need for investigation;
  - Issues referred by ATO rendering the need for investigation, which may have been identified during compliance of other areas of a company's tax compliance.
- AusIndustry 'R&D Expenditure Compliance team' should be adequately resourced to allow them to:
  - Liaise with ATO to conduct integrity reviews of Refundable Offset claims prior to release of funds, particularly for first time claimants;
  - Derive any company tax information from ATO that is required to assess R&D Expenditure compliance;
  - Provide a support level to advisors and companies similar to that of current AusIndustry staff or the former ATO Innovation support service.

Moving to a discretionary grant programme rather than a broad based scheme administered through the tax system:

Within the Issues Paper, reference is made to other global jurisdictions that offer grant-based innovation systems rather than broad-based innovation systems administered through taxation systems.

It has also been speculated that this may be an option for future changes to the R&D Tax Incentive.

Swanson Reed is of the view that a move to a grant-based programme would drastically reduce the effectiveness and attractiveness of the programme as:

- A grant-based system would reduce the additionality impacts of the R&D Incentive, since companies are less likely to invest in R&D Activities if their receipt of support was competitive rather than entitlement based.
- A grant-based system would likely reduce the instance of start-up ventures and slow their progress. The process for assessing grant applications can often be time consuming and would not likely fulfil a start –up's needs for certain, robust capital.
- A grant-based system would reduce the ability of the R&D Tax Incentive to attract international investment. Government grants understandably favour Australian companies and the process of grant application would be daunting to overseas companies.
- A grant-based system would likely require a larger staffing by AusIndustry to thoroughly assess applications before release of funds.
- A grant-based system would make the R&D Tax Incentive much harder for participants to access, which is one of the key points of focus within the current review's scope.

### **What is the role of the R&D Tax Incentive in pursuing other objectives, such as international tax competitiveness and collaboration with publicly-funded research bodies?**

The crucial role the R&D Tax Incentive plays in attracting investment to Australia R&D over competing global destinations has been discussed at length within Swanson Reed's previous submissions.

In respect of the policy objective of collaboration, Swanson Reed concurs this should be a focus and recognises that the 9.5% rate of collaborative projects cited in the Issues Paper is an area for future improvement within the programme.

One potential option could be to offer a concessional or enhanced rate of treatment for R&D expenditure incurred for services from Research Service Providers (RSPs) and Universities. For example, expenditure incurred by an RSP could be subject to a more attractive rate of offset, such as:

- A 65% R&D Tax Offset for companies claiming under the current refundable R&D Tax Offset (\$0.65 cash refund for claimants in tax loss, \$0.35 permanent benefit for taxable entities); and
- A 55% Rate for companies claiming under the non-refundable R&D Tax Offset (\$0.25 permanent benefit).

Such an enhanced rate of Offset would encourage companies to procure services from RSPs or research institutions when conducting R&D Activities, thus increasing the rate of collaboration.

Subtle changes could be made to the design of the programme to offset any additional cost from offering the enhanced rate of recoupment for RSP expenditure. This may include restricting claims for types of expenditure less likely to generate the spill over benefits the programme seeks to create, such as:

- Notional deductions for the decline in value of R&D Assets;
- Allocations of corporate overhead expenditure directly related to R&D Activities.

### **How does the R&D Tax Incentive compare with international practice around support for business R&D?**

Australia's R&D Tax Incentive programme has become well regarded internationally and, combined with the recent decline in the Australian dollar, has been a driver of overseas investment in Australian R&D.

The international benchmarking of Global R&D Tax Schemes within the Issues Paper highlights that the Australian R&D Tax Incentive system is relatively competitive with international regimes.

Since global companies' investments in R&D Activity are often undertaken on a long-term basis, it is crucial that Australia's R&D Tax Incentive remains competitive and stable to allow global companies to have the confidence to invest in Australian R&D.

It is also important to note that Australia does not offer a “patent box” type incentive for the domiciling of IP, which has been discussed within previous Swanson Reed submissions.

Recent amendments to the UK patent box have been made to address OECD concerns and make the regime “Base Erosion and Profit Shifting (BEPS) compliant”. The amendments include rules to coerce companies utilising patent box to also conduct their underlying R&D activities in the UK. Other countries offering patent box incentives are likely to implement similar rules encouraging local R&D Activity, thus increasing global competition for R&D investment.

An Australian patent box initiative does not appear to be on the policy agenda given current budgetary constraints, and was not proposed within the recent Innovation Statement announced in December 2015.

The absence of a “patent box” type incentive makes the attractiveness and stability of our R&D Tax Incentive even more crucial for attracting investment in a globally competitive market.

**What is the historical and projected cost of the R&D Tax Incentive? What drives the costs?**

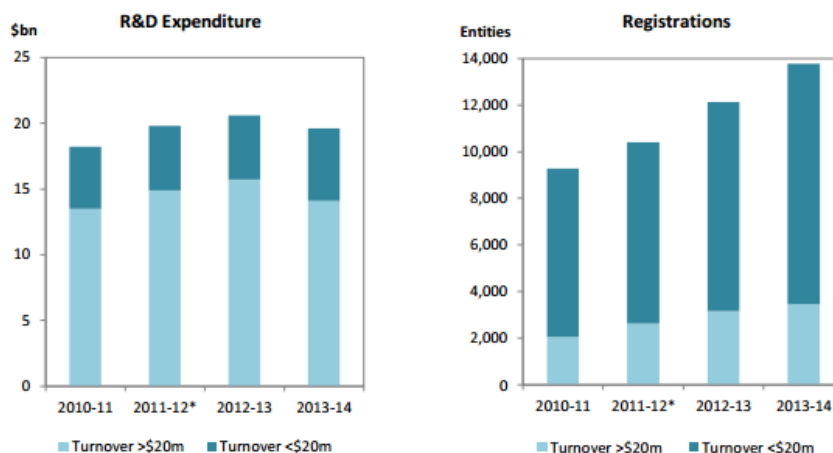
Swanson Reed recognises the need for budget prudence, and it is important that the cost of the R&D Tax Incentive is accurately measured and controlled.

Budget measuring of the R&D Tax Incentive must, however, gauge the true cost and benefits of the programme, incorporating both:

- Timing adjustments arising from the programme’s design of supporting phases of investment at companies’ expense of forgone tax losses; and
- Spill overs from investment in the activities which the R&D Tax Incentive supports.

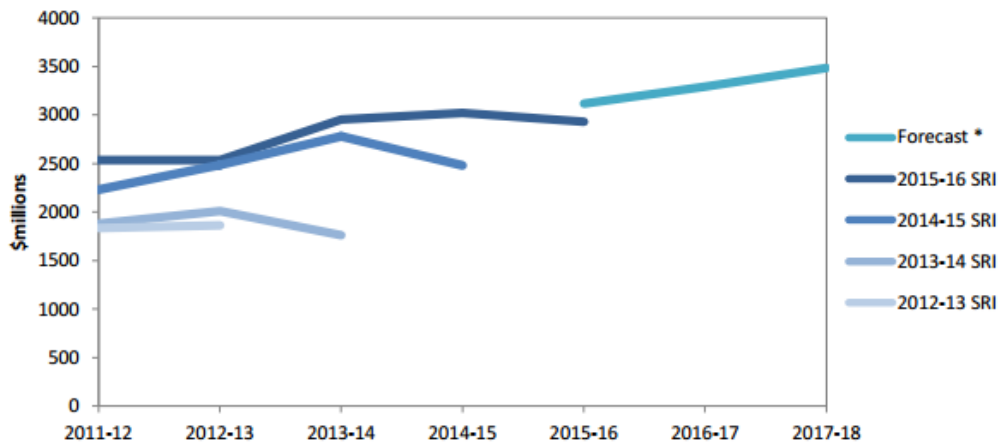
Swanson Reed is concerned about how the cost of the Refundable R&D Tax Offset may have been calculated within the Issues Paper when reviewing the following tables cited:

**Figure 1: Total R&D expenditure and registrations in the R&D Tax Concession and Tax Incentive**



\* 2011-12 was a transitional year in which some firms accessed the R&D Tax Concession while others accessed the R&D Tax Incentive.

Figure 2: Cost revisions to the R&D Tax Incentive



\* The Forecast uses estimates from the 2015 Tax Expenditure Statement combined with previously unpublished projections from the 2015-16 MYEFO. This mimics the estimates presented in each SRI document, which are based on the expense estimates underpinning the relevant Budget combined with tax expenditure estimates from the relevant Tax Expenditure Statement.

Source: Science, Research and Innovation Budget Tables, Department of Industry, Innovation and Science.

In particular we note:

- Total Business R&D Expenditure within Figure 1 of the Issues Paper shows a decline in R&D Expenditure in 2013-14 relative to 2011-12 and 2012-13.
- Annual cost of the programme is reported as having increased \$0.5 billion between 2011-12 and 2013-14.
- The approximate permanent benefit of the total business R&D Expenditure within Figure 1 of the Issues Paper would indicate a permanent cost of the 2013-14 period figures to be Approx. \$2.25 billion, calculated as follows:
  - Approx. \$5 billion in R&D Expenditure claimed under the Refundable Offset @ a permanent cost of foregone tax revenue of \$0.15 = \$0.75 billion cost; *plus*
  - Approx. \$15 billion in R&D Expenditure claimed under the Non-Refundable Offset @ a permanent cost of foregone tax revenue of \$0.10 = \$1.5 billion cost.
- The cost of the R&D Tax Incentive for the 2013-14 period is cited within the Issues Paper as being almost \$3 billion, which is an excess of \$0.75 billion over our calculations of the permanent cost on the reported expenditure.
- Growth in the cost of the Refundable Offset component of the programme is highlighted as a key driver of costs being higher than expected.

While the basis for the costing of the programme is unknown to us, the above analysis leads us to conclude that the cost of the refundable component of the programme is calculated based only on the temporary cash outlay, which is a key design feature of the programme.

This method does not, however, incorporate the programme's *permanent* effect on corporate tax receipts and disregards temporary financing benefits of the R&D Tax Incentive from factors such as:

- The forfeiture of tax losses for R&D Expenditure Claimed under the refundable R&D Tax Offset. These forgone tax losses have the effect of “bringing forward” corporate tax payments of claimant companies. Our analysis indicates that the current costing methodologies:
  - May not consider that corporate tax receipts from claimant companies will be accelerated, since the company does not carry forward tax losses foregone in exchange for receipt of refundable offsets;
  - May not credit the subsequent \$0.30 tax receipt from the foregone tax loss on \$1 of R&D Expenditure against the original \$0.45 accrued to the cost of the R&D Tax Incentive. For example, under the current costing method, a \$30,000 tax payment made by a company in the FY16 year may not be subtracted against the cost of a \$45,000 refundable offset on \$100,000 R&D investment that the same company received in the FY12 year. However, if the company did not claim the refundable offset in the FY12 year, it would have maintained its tax loss balance available for application against subsequent taxable income, meaning no corporate tax payment would have occurred in the FY16 year if the refundable offset was not received in FY12.
- Other timing adjustments arising under the R&D Tax Incentive, such as:
  - Feedstock adjustments taken up in subsequent periods;
  - Impact of dividend franking constraints arising from the claiming of R&D Tax Offsets.

Swanson Reed acknowledges that it would not be prudent to assume all companies receiving refunds from the R&D Tax Incentive will commercially succeed, and that all tax losses forgone under the Refundable R&D Tax Offset will lead to accelerated recoupment of corporate tax receipts in future. However, the forfeiture of tax losses must somehow be incorporated within the measurement of cost if this is not occurring already. This effect could perhaps be incorporated within the costing determining what portion of claimants receiving refundable offsets go on to pay tax within the forward estimate periods, and then building into the costing model the impact of accelerated corporate tax receipts based on historical rates.

It is also important to note that the “cost” of the R&D Tax Incentive is far more likely to provide a capital/investment return than other areas of tax concessions or government expenditure. Hence, when measuring the cost of the programme, consideration must also be given to the intangible spill overs generated from the conduct of the R&D activity that the programme funds.

### **How could the R&D Tax Incentive be made easier for participants to understand and access?**

Given the rapid rise in number of claimants cited within the Issues Paper, it would appear that the programme is meeting objectives for ease of access.

In respect of participant's understanding of the programme, we note that both AusIndustry and the ATO have now made available extensive volumes of guidance material covering the various compliance issues relevant to each jurisdiction.

Swanson Reed also has positive feedback on AusIndustry's hotline service, workshops and assistance from customer service managers based on our own experience and those of our clients.

Such services have been instrumental in educating stakeholders on the eligibility of activities and expectations for programme participation.

An improvement point for enhancing the programme would be to adequately resource the ATO for reintroduction of the Innovation Tax support facility. When previously operational, this facility was valuable for assisting advisors resolve technical issues arising from complex R&D Tax-specific matters. General ATO support staff may not be able to sufficiently address such queries and there is a requirement for a dedicated ATO support service. In the absence of such technical support, a private ruling must be sought, which can often be time-consuming for the ATO, companies and their advisors.

## Conclusion

In summary, we wish to reaffirm the importance of a commitment to the stability of the current R&D Tax Incentive.

Innovation policy and incentives have been subject to an ongoing series of reviews and proposed changes over the past decade. While such reviews facilitated the introduction of the superior R&D Tax Incentive as successor to the R&D Tax Concession, a period of stability must now prevail.

There may be opportunity to enhance the efficiency of the R&D Tax Incentive; however, any changes must not adversely impact the fundamental structure of the programme, which provides a broad-based, easily accessed and significant Incentive.

This is particularly the case as scarce R&D capital is increasingly mobile, and there is intensifying global competition for R&D investment by other jurisdictions offering generous and stable incentives.

We also wish to re-emphasise our concerns that the programme cost figures within the Issues Paper appear to be significantly overstated given the apparent failure to consider forgone tax losses from refundable offset claims. The basis for costing of the R&D Tax Incentive must be carefully examined so as to be measure the true cost and benefits of the programme.

Please do not hesitate to contact me on (07) 3221 1499 if you would like to discuss any aspect of this submission.



Damian Smyth  
*Chief Executive Officer*  
Swanson Reed