SCIENCE & TECHNOLOGY AUSTRALIA

RESPONSE TO THE REVIEW OF THE R&D TAX INCENTIVE CONSULTATION

27 October 2016

Please accept this submission from Science & Technology Australia (STA) in response to the consultation on the 2016 *Review of the R&D Tax Incentive*.

In summary, STA strongly agrees with most of the recommendations in the review, and congratulates Mr Ferris, Dr Finkel and Mr Fraser on returning a well-written, clearly articulated and comprehensive review document that attempts to strike a clear balance between the needs and pressures of the different sectors involved in R&D.

In particular, STA welcomes the recommendation in support of greater cross-sector collaboration, which we believe is an important and lacking area of support currently.

We also support recommendations intended to broaden access to incentives, and to provide clarity and guidance regarding eligibility, reduce duplication and red tape.

STA urges the Government to implement these recommendations, and further urges the Government to direct any savings from these measures back into the broader Australian research sector and the infrastructure that supports it.

Please find below specific responses to each of the recommendations. We are available for further consultation should you wish to seek more information or clarification on any part of this submission.

Yours Sincerely,

Kylie Walker
Chief Executive Officer
Science & Technology Australia

Professor Jim Piper
President
Science & Technology Australia

<u>Responses to specific recommendations:</u>

Recommendation 1: *Retain the current definition of eligible activities and expenses under the law, but develop new guidance, including plain English summaries, case studies and public rulings, to give greater clarity to the scope of eligible activities and expenses.*

Strongly Agree.

Vague or inconsistent definitions cause unnecessary complexity in undertaking the application process. STA believes it would be useful to improve the clarity of guidance relating to eligibility guidelines and in particular the novelty of proposed research and its ability to produce new knowledge.

Definitions should be kept as consistent as possible to guard against misinterpretation and ensure a shared understanding of intent. They should also clearly state what part of the life cycle of development is eligible for premiums, concessions and incentives.

STA would caution against providing too much information: start-ups, in particular, are time-poor and more information is not always useful. Rather than providing lots of reading material, we suggest the administering Departments consider employing consultants or advocates to discuss the application process and eligibility criteria with those who require guidance.

Prior to roll-out, STA urges the Department to test any new forms, definitions and processes with real potential applicants, from start-ups to SMEs to big business, to iron out any inconsistencies, remove irrelevant or inappropriate questions, cut down on bureaucratese and leave no room for misinterpretation.

Recommendation 2: *Introduce a collaboration premium of up to 20 percent for the non-refundable tax offset to provide additional support for the collaborative element of R&D expenditures undertaken with publicly-funded research organisations. The premium would also apply to the cost of employing new STEM PhD or equivalent graduates in their first three years of employment. If an R&D intensity threshold is introduced (see Recommendation 4), companies falling below the threshold should still be able to access both elements of the collaboration premium.*

Strongly Agree.

STA recognises that the scheme has not previously had the object of increasing cross-sectoral collaboration. Neither does it exclude such collaboration, but in practice the detail of how the current scheme works acts as a disincentive to such collaboration in favour of entirely in-house R&D. It follows that only a small percentage of projects involve collaboration outside the companies. Failing to make collaboration an objective of the scheme is to the continuing detriment of R&D in Australia, and STA is strongly supportive of measures to redress this, particularly in the context of the National Innovation and Science Agenda's objective to enhance and encourage cross-sector collaboration. The percentage of research being done in collaboration outside large companies in Australia is small when compared with international counterparts. This is particularly concerning as there exists strong international evidence that research done by firms in collaboration with other kinds of organisations has much higher direct and indirect returns and benefits than research done in isolation. STA believes Australia urgently needs to address its extremely poor inter-sector collaboration and strongly supports the move to provide for stronger collaboration as in the national interest.

STA is also strongly in favour of any measure that enhances employment prospects for STEM graduates. Studying science, technology, engineering and mathematics equips graduates with analytic, problem-solving and lateral thinking skills; with the ability to view failure as a learning opportunity, and with a thirst for knowledge and learning. These skills and attributes will be vital for the jobs of the future. Increasing the number of STEM graduates in industry will give business managers first-hand experience of their analytic and creative problem solving skills and can only serve to enhance industry views of the value of a PhD.

STA believes this recommendation should be implemented regardless of the decisions made regarding other recommendations in this review.

Recommendation 3: *Introduce a cap in the order of $2 million on the annual cash refund payable under the R&D Tax Incentive, with remaining offsets to be treated as a non-refundable tax offset carried forward for use against future taxable income.*

Agree (with reservations)

STA recognises that the current growth of the scheme is unsustainable if it continues indefinitely and that the current structure may be encouraging less than ideal practices. If there is evidence that many SMEs are claiming more than $2 million, introducing the cap would constrain use of the fund and ensure its sustainability.

However, we recognise that this tax offset (cash payment) is used by small companies – usually start-ups – as additional operating cash, and that this can have an enormous proportionate impact on the company's prospect of success. Capping this amount may unfairly penalise those SMEs that are particularly research-oriented – the very companies that the R&D tax incentive seeks to encourage and support.

We also question whether there are sufficient alternative practices to encourage healthy investment in R&D for the big companies that often make the most substantial investment in research.

In assessing the merits of this recommendation it would be useful to articulate the number of claims of more than $2 million currently made by small companies (with a capitalisation of under $20 million).

Recommendation 4: *Introduce an intensity threshold in the order of 1 to 2 percent for recipients of the non-refundable component of the R&D Tax Incentive, such that only R&D expenditure in excess of the threshold attracts a benefit.*

Agree.

STA supports this measure as a balance to ensure the scheme is not used to subsidise business-as-usual activity, and to further incentivise companies to invest in and focus on R&D. The current scheme has over 30 years supported a culture within Australian companies that any and all research undertaken should be subsidised by the public. We believe this attitude has perversely contributed to the low levels of R&D investment by Australian companies on international comparison.

However, we caution that creating a threshold of this type could encourage gaming the system (ie. those that fall just short of the threshold may include in claims activities that are not strictly the target of the incentive): it may be preferable to instead introduce a sliding scale.

Recommendation 5: *If an R&D intensity threshold is introduced, increase the expenditure threshold to $200 million so that large R&D-intensive companies retain an incentive to increase R&D in Australia.*

Strongly agree providing recommendation 4 is introduced.

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Consistent with Recommendation 4, STA agrees that the cap should be increased. If the intensity threshold is introduced, this measure would ensure that highly R&D intensive companies are not penalised or unintentionally disincentivised.

To avoid confusion, STA recommends that the word ‘threshold’ is not used for this measure, but rather ‘cap’ or similar. As it stands, the definition of ‘threshold’ for recommendation four is directly opposite the definition of ‘threshold’ for recommendation five.

Recommendation 6: *That the Government investigate options for improving the administration of the R&D Tax Incentive (e.g. adopting a single application process; developing a single programme database; reviewing the two-agency delivery model; and streamlining compliance review and findings processes) and additional resourcing that may be required to implement such enhancements. To improve transparency, the Government should also publish the names of companies claiming the R&D Tax Incentive and the amounts of R&D expenditure claimed.*

Agree.

A single application process and program database would simplify the application process and make it cheaper and more accessible to companies of all sizes, reduce compliance costs and duplication in bureaucracy, and improve coordination across government.

While we note the difficulties and complexities of involving two different Government organisations in administering this scheme, there are good reasons for maintaining this arrangement. AusIndustry plays a critical role in supporting business innovation and growth, while the ATO is focused on strong financial management for the Government. Simplification of the scheme can more appropriately be addressed through clarifying definitions and the application process.

STA strongly supports moves towards greater transparency and is in favour of publishing claimants’ details.