Committee for Sydney

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

Submission from the Committee for Sydney

March 2020

Thank you for the opportunity to comment on the *Treasury Laws Amendment (Research and Development Tax Incentive) Bill 2019*.

About the Committee for Sydney

The Committee for Sydney is an independent think tank and champion for the whole of Sydney, providing thought leadership beyond the electoral cycle. Our aim is the enhancement of the economic, social, cultural and environmental conditions that make Sydney a competitive and liveable global city.

Executive Summary

The Research and Development Tax Incentive (RDTI) is one of the most effective tools that the Australian Government has to support innovation and productivity growth in the economy. However, recent changes (including the current proposal) have reduced the overall scale of the RDTI, meaning fewer firms are claiming smaller amounts. The Committee for Sydney believes that the proposed changes will not, on balance, improve the level of Research & Development in Australia. Specifically, we recommend:

- The rejection the introduction of a cap on refundable tax offsets;
- Support for the proposed raising of the cap on non-refundable tax offsets from $100 million to $150 million;
- Rejection of the proposed intensity measures, which will not drive more efficient use of the RDTI, but will introduce unnecessary complexity and will disadvantage firms undertaking substantial non-R&D work in Australia.

Australia's R&D is heading in the wrong direction.

Australia's total R&D spend has now dropped to just 1.79% of GDP, well below the OECD average of 2.37%. Analysis from EY shows that current R&D expenditure is dropping substantially in Australia.

RDTI Claims over the past 5 years are dropping

Table by EY	R&D Expenditure		Non-refundable offsets			Refundable offsets		Total offsets		Total cost	
Financial Year	Non refundable	Refundable	Tax offsets	Deduction	Net	Tax offset	Deduction	Offsets	Deductions	Net cash	Accrual
2014/15	**14.5**	**5.2**	5.80	4.35	**1.45**	**2.34**	1.56	8.14	5.91	**3.79**	**2.23**
2015/16	**11.3**	**5.3**	4.52	3.39	**1.13**	**2.39**	1.59	6.91	4.98	**3.52**	**1.93**
2016/17	**9.3**	**5.7**	3.58	2.79	**0.79**	**2.48**	1.71	6.06	4.50	**3.27**	**1.56**
2017/18	**7.5**	**5.7**	2.90	2.25	**0.65**	**2.50**	1.57	5.40	3.82	**3.15**	**1.58**
2018/19	**7**	**5.2**	2.70	2.1	**0.60**	**2.30**	1.43	5.00	3.53	**2.90**	**1.47**

All numbers in Billions AUD.

The above table has been developed by Ernst & Young using ATO data and prevailing offset rates and tax rates. What this shows is that over the past 5 years, the amount of research & development expenditure has been dropping, with a reduction of over 50% for non-refundable claims.

These proposed changes will continue to send R&D in the wrong direction – reducing the amount happening right at the time when we should be massively expanding our expenditure on R&D.

Currently Australia sits well below the OECD average for R&D expenditure. While we are above average for the amount of government support for R&D, we sit well behind many competitor nations – and when taken in combination, it is clear that more needs to be done to boost research and development in Australia. These changes will not achieve this, further reducing our position in relation to other countries, and risking our ability to compete globally.

Research and Development Expenditure overall and by Government as a percentage of Gross Domestic Product

Country	% of GDP – total spend on R&D	% of GDP - Government support for R&D
Israel	4.94%	0.11%
South Korea	4.53%	0.13%
Sweden	3.31%	0.13%
Japan	3.26%	0.15%
Austria	3.22%	0.26%
Germany	3.13%	0.07%
Denmark	3.03%	0.06%
United States	2.83%	0.22%
Finland	2.75%	0.06%
OECD Average	**2.40%**	**0.13%**
France	2.20%	0.40%
China	2.19%	0.13%
The Netherlands	2.16%	0.18%
Norway	2.07%	0.23%
Iceland	2.03%	0.23%
European Union	2.03%	N/A
Singapore	1.94%	N/A
Australia	**1.79%**	**0.19%**
Great Britain	1.71%	0.30%
Canada	1.54%	0.23%
Italy	1.39%	0.19%
New Zealand	1.37%	0.10%
Greece	1.18%	0.02%
Ireland	1.15%	0.20%
Russia	0.99%	0.48%

Source: OECD and OECD

We recognise that there is many different opinions on what shape Australia's R&D system should take – but what is not disputed is that the current amount of spending dedicated to R&D is far below that of competitor countries and should be expanded. Without an expansion in the RDTI, we will not see Australia maintain its run of economic success and global competitiveness as our economy transitions.

Potential positive changes to the RDTI that should be explored

There are three alternative options that should be explored to boost R&D in Australia.

In the UK, Ireland, Belgium, the Netherlands, Switzerland, Turkey and China all have introduced different forms of "Patent Box" tax concessions. A patent box is a tax incentive scheme which reduces the tax payable on income derived from intellectual property, particularly patents. The aim of the scheme is to provide an incentive for companies to retain and commercialize patented inventions and to pursue patent protection for new inventions in their home country.

In Ireland, they have also introduced reforms that will allow small firms with up to 250 works claim the R&D tax credits while products are in the development stage and yet to generate sales, as opposed to having to wait until the company is turning profits before claiming an offset against company tax.

Another option to boost R&D investment would be to offer research and development tax break for businesses that collaborate with universities and government scientists on innovation. This could be done through the introduction of a "premium rate" R&D tax break for companies partnering with the CSIRO and Universities, set at 20%, as recommended by Bill Ferris in his innovation review.

Conclusion – understanding the trade-offs

The Committee is aware that expanding the RDTI involves pressure and uncertainty for the Federal budget in the short term. We also understand that there are immediate fiscal constraints as a result of impacts of bushfires and COVID-19.

However, the long-term consequences of reducing the RDTI are significant, and we believe that constraining this program now will have a negative impact on the prosperity of Australia as we seek to transition our economy to more knowledge-intensive industries.

We urge the committee to recognise the long-term risks in reducing expenditure on the RDTI and recommend changes that would expand the program.