Review of the R&D Tax Incentive

KPMG Submission

Foreword

Why things need to change

Over the last 10 years, Australia’s global innovation ranking and innovation efficiency index (our ability to convert ideas into commercial successes) have both dropped. This needs to change - our future economic prosperity depends upon it.

The R&D Tax Incentive (the Incentive) helps drive greater innovation by industry, via a sometimes refundable tax offset for expenditure on research and development (R&D). This is a valuable, and for many vital, programme. However as more companies access the programme, its cost is becoming untenable.¹

The Government’s National Innovation and Science Agenda (the NISA) is intended to address these problems and find ways to increase innovation and its benefit to our economy. Containing the cost of the Incentive (to ensure its long term viability) while sharpening its focus on additionality and spillover is a key component of the NISA. The ensuing review by Mr Bill Ferris AC, Dr Alan Finkel AO and Mr John Fraser makes a number of recommendations to that end.

This submission provides feedback on these recommendations and considers what more can be done to protect the long term viability of the Incentive while increasing additionality and spillover.

What to change

We recommend Government:

1 develop clear guidance including industry case studies which illustrate how companies identify activities as eligible R&D activities and also ineligible activities, along with examples of contemporaneous documentation that supports the R&D claim.

2 implement a collaboration premium, but consider reducing and capping the benefit so that it can be accessed by more companies.

¹ While beyond the scope of the Review, if Australia is to lift its gross expenditure on R&D (GERD) as a percentage of GDP, it is foreseeable that it will need to invest more in government programs to support and incentivise business expenditure on R&D (BERD). This will take significantly more investment than is currently the case.
3 implement a cap on the refundable tax offset, but consider increasing the amount or allowing for exceptions where the R&D activities meet certain criteria.

4 reject any intensity threshold that doesn’t provide a benefit below the threshold amount or which is based on a metric unrelated to R&D (i.e. total business expenses);

5 increase regulator review activity to improve compliance by both taxpayers and their advisors;

6 consider mechanisms to contain the long term cost of the program, especially in relation to its greatest cost component, the refundable tax offset;

Why listen to KPMG?

KPMG advises industry on a range of innovation issues, not just in Australia, but around the world. We have also invested heavily within our own business to build and embed an innovative culture; we ‘walk the talk’ when it comes to innovation. This has included investing organically to incubate new services and building alliances which change the way we relate to our clients.

We believe KPMG’s experience advising large and small innovative companies and our own journey can help inform government policy – aimed at making Australia a better place to innovate and making sure government support for innovation works to increase business expenditure on R&D.

Productivity and innovation – key to prosperity and higher living standards

Australia’s growth in multifactor productivity, a proxy measure for the pace of innovation, is lower now than it was on average during the 1990s and early 2000s. To remedy this, we need to focus on innovation; innovation in products and process, business model and in public policy and service delivery.

Alignment with the NISA

In response to the NISA announced in December 2015, we said that innovation is not just about start-ups, but about new thinking and transformation in existing businesses. Critically, it is about businesses staying in Australia and engaging with disruptors. If we don’t meet these challenges, business will move elsewhere, intellectual property will be licensed rather than owned by Australians and our long term growth as a nation will be impacted with severe consequences.

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2 Tax concessions, grants, investment, strategy, scaling and overseas markets.
3 Business expenditure on R&D (BERD) in Australia is about 1.27% of GDP.
4 A broad measure of efficiency and innovation in the market economy that reflects the skill and cleverness with which capital and labour are combined to produce a given amount of output.
5 Dr Martin Parkinson, Secretary of the Department of Prime Minister and Cabinet, in his CEDA State of the Nation Keynote Dinner Address, 10 October 2016 (CEDA Address).
6 Dr Martin Parkinson, CEDA Address, 10 October 2016.
7 KPMG, Finding our innovation mojo, submission on the National Innovation and Science Agenda, December 2015.
The International Monetary Fund (IMF) has recommended that governments do more to encourage R&D; in advanced economies, the IMF says companies should invest 40% more in R&D and that if they did, it would lift GDP in individual economies by 5% in the long term and globally by as much as 8%; largely due to knowledge spillover. The IMF notes that advanced economies can achieve this dividend through well-designed policies that include fiscal R&D incentives and complimentary public investments in basic research.8 Relevantly, Swinburne University found that those claiming the Incentive invest around 40% more in R&D than those that do not9; suggesting the Incentive may be instrumental to achieving that objective.

In his recent CEDA Address, Dr Martin Parkinson also commented that:

We tend to think of innovation as being done by start-ups or people in white coats, but it’s much more than that. By and large our greatest gains have come from building a culture that adapts and diffuses the ideas of others. [...] Government has to do the same when it comes to policy development and implementation. The work underway around rethinking our ways of engaging with the community, particularly around service delivery is one example of public sector innovation.10

We agree with these sentiments and suggest that measures precluding large companies from claiming the Incentive undermine the crucial role of the Government supporting innovation through its NISA. In this regard, we believe that some recommendations coming out of the recent review of the R&D Tax Incentive, particularly the recommendation to apply an intensity threshold, will lead to a reduction in larger companies’ innovation mojo.

Introduction

The Report


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10 Dr Martin Parkinson, CEDA Address, 10 October 2016.
11 The review was undertaken by Mr Bill Ferris AC (Chair, Innovation Australia), Dr Alan Finkel AO (Chief Scientist) and Mr John Fraser (Secretary to the Treasury), collectively referred to as the ‘3Fs’.
12 Recommendations 1, 3 and 6 are aimed at improving the integrity of the programme, while recommendations 2, 4 and 5 are aimed at improving the effectiveness of and level of additionality flowing from the Incentive. See Report, page 2.
This Submission

KPMG is committed to improving the Incentive and improving industry R&D; we believe that this is critical to Australia’s future economic prosperity.

Overall, we agree in principle with most of the recommendations, recognising that further work is required in relation to the form in which they should be implemented and their practical operation. There are two recommendations, however, that we believe will undermine the effectiveness of the Incentive, including its ability to promote additionality and spillover.13

Our Concerns

One key concern for KPMG is the proposed introduction of an intensity threshold. We believe the proposed shift away from the current volume based Incentive fails to recognise the Incentive’s role in companies’ decisions to invest in R&D. The assumption that, in the absence of access to the Incentive, companies with a low R&D intensity will spend money on R&D in Australia anyway (rather than reducing their R&D spend or conducting R&D offshore) is unfounded. We are also concerned that an intensity threshold in the form proposed by the Report will create additional complexity and compliance costs for businesses, acting as a further deterrent to conducting R&D in Australia.

The timing of the proposed changes must also be carefully considered. Businesses that invest in R&D require stability and certainty in order to plan their R&D investment in the face of global economic volatility. Having already had several changes to the Incentive in the last 18 months,14 any further changes must be carefully assessed against the additional uncertainty created for taxpayers and the potential to discourage future investment in R&D. Studies have found that the beneficial effects of R&D tax credits in OECD countries are greatly reduced when an instrument is modified frequently.15 This has previously been demonstrated in the Australian context.16

Changes that introduce new definitions or provisions are likely to cause uncertainty while changes that leverage existing definitions or provisions are less likely to cause uncertainty. Reducing benefit rates, use of caps and thresholds like aggregated turnover will be readily understood by industry as they already exist within the program. Introducing new terms such as collaboration premiums and intensity thresholds will take time and may result in unintended consequences.

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13 Recommendation 3 ($2 million cap on cash refund) and Recommendation 4 (1-2% intensity threshold).
14 Including introduction of the $100m cap in 2015 and reduction of the offset rates by 1.5% effective from 1 July 2016.
16 In 1996, cuts to Australia’s previous R&D Tax Concession reduced business expenditure on R&D (BERD) for the next 5 years with a drop of over 9% in the BERD to GDP ratio from 1996 to 2000. When further changes were announced towards the end of 2009, the rate again dropped (1.34% down to 1.24%). See Australian Bureau of Statistics, BERD Reports 2000 to 2012 and Australian Innovation System Report Tables, page.
Finally, we are also conscious that this most recent review of the Incentive was commenced prior to implementation of the offset rate reductions passed into law earlier this year, which are projected to provide savings of up to $600 million over three years. The impact of these changes, including the effect on R&D investment by industry, should be assessed when considering which (if any) of the recommendations should be implemented, the form any changes should take, and the timeframe for implementation.

KPMG Commentary

Report 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

The definition of eligible R&D is based on international norms (OECD Frascati Manual), providing a nationally and internationally consistent definition for over 30 years. Further, the Frascati Manual and several other internationally recognised documents make up the Frascati Family, used to measure and promote science and technology. One of those documents is the Oslo Manual, which the Government has referenced in its new angel investor tax break aimed at supporting early stage innovation companies. Departure from the Frascati Family in the context of the Incentive would both undermine Australia’s international standing and be contrary to the Government’s use of the Frascati Family in other areas. We therefore strongly agree with recommendation 1 that the definition of eligible activities under the Incentive should be retained.

We further agree with the proposal to develop new guidance, including plain English summaries, case studies and public rulings; taking care to cite case law and legislation in a balanced way.

Case studies should be based on real industry examples, including; the method by which the company identified R&D activities (including identification of ineligible activities), how the R&D activities were described for the purposes of registration, and contemporaneous documentation retained to support the activities and expenditure thereon.

17 From financial year 2017/18 to financial year 2019/20. See Revised Explanatory Memorandum to the Budget Savings (Omnibus) Bill 2016 (Cth), Page 6.
18 The Frascati Manual was first developed in 1963, but not adopted in Australia until the first R&D Tax Concession in 1986.
19 For instance recent draft guidance quoted only part of a paragraph in JLSP and Innovation Australia [2016] AATA 23; the full paragraph of which altered the meaning from that suggested in the guidance.
Report 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.

We agree that a collaboration premium (the Premium) provides a good incentive for companies to increase the use of publicly funded research organisations (PFROs) and employment of new STEM PhD or equivalent graduates. We also agree with the Report that the Premium should apply to all qualifying expenditure, including expenditure below the intensity threshold (if a threshold is introduced).

Whether the Incentive is the appropriate programme by which to implement this measure, however, should be carefully considered. Introduction of the Premium will complicate the Incentive and create uncertainty as to its operation. It would be easier and cleaner (from a legislative point of view) to create the Premium under its own Division in the Income Tax Assessment Act 1997 (Cth) (ITAA 1997) and amend section 355–715, ITAA 1997 to enable qualifying expenditure to be claimed under both.

Looked at on its own, there are also still a number of questions around how it would work and why it should be restricted to larger companies. Under the NISA, Government is changing its national assessment of the engagement and impact of university research to include commercial outcomes; an objective of which is to encourage public researchers to collaborate with industry. This and the Premium are both intended to encourage greater collaboration. We agree both are effective tools for doing this, but we believe it would be better if the Premium was offered at a lower rate to more types of expenditure and not just larger companies.

Further, from a cost containment perspective, it might be prudent to cap the Premium amount, lest the Premium significantly increase the cost of the Incentive over the longer term.

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20 NISA Initiative: Measuring impact and engagement of university research.
21 Note this cost should be partially offset by the additional funding it will provide to PFROs, thereby potentially lessening the direct cost burden of PFROs on the public revenue.
Premium rate

The proposed premium rate is an additional 20% tax rebate on qualifying expenditure, including expenditure below the proposed intensity threshold. For qualifying expenditure above the threshold, the R&D tax offset rate will be 58.5%.

We believe it would be preferable to offer a lower premium to more companies and/or a wider variety of researchers and research organisations. For instance, a 5% or 10% non-refundable collaboration premium could be offered to all claimants, not just those accessing the non-refundable tax offset. This would need to be modelled by Treasury to determine cost and anticipated benefit.

Restriction to larger companies

The Report states that larger companies provide better spillover, and while this may be correct, this recommendation offers nothing for small companies – companies may greatly benefit from the research capacity and capability available within PFROs. Further, encouraging small companies to engage with PFROs early in the development cycle fosters an innovation and collaboration culture that will be retained as the company grows. If the premium is intended to foster greater collaboration between industry and PFROs, we recommend it be extended to all companies.

Restriction to PFROs

The restriction to PFROs could be viewed as a cost saving exercise to partially shift funding of PFROs from Government to industry. Restricting the Premium to PFROs ignores the value of collaboration with non PFROs, including research service providers (RSPs), associations and other research organisations.

Under the NISA, Government is creating technology precincts, growth centres and cooperative research centres (CRCs) aimed at increasing global competitiveness through better collaboration and spillover – not just between industry and researchers, but also within industry.

Conceptually the Premium could be similarly used to encourage companies to collaborate within this framework. This would mean extending the Premium beyond research organisations to other companies in some circumstances. However, this should be approached with caution as it will increase the cost base and may be open to abuse.

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22 While greater collaboration between public researchers and industry is needed, it is hoped this does not lead to less public funding for PFROs over the longer term.
23 For instance industry associations often have a whole of industry view that PFROs do not, including knowledge of industry trends, commercial drivers and market gaps.
24 Such as private universities, not-for-profit research organisations, etc.
Restriction to PhD and equivalents

Where the Report refers to the Premium being available for companies employing new STEM PhD graduates, it is not clear if the first 3 years of employment refers to the first 3 years after graduating or the first 3 years with a given company and how this will apply to contractors rather than employees.

Further, the number of STEM postgraduates is low compared to STEM graduates, meaning the total number of people who fit the definition of ‘PhD graduates or equivalent’ is likely to be relatively low. Industry needs more STEM employees now, preferably with industry experience, not only those with highly specialised and niche STEM postgraduate qualifications. We believe it would be better to extend the premium to STEM graduates as well as post graduates. This would need to be modelled by Treasury to determine cost and anticipated benefit.

Report 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.*

The Report notes this recommendation is aimed at improving integrity of the programme\(^{25}\) and that cash refunds represent an increased compliance risk.\(^{26}\) Given this measure simply caps the cash refund, it is hard to see how programme integrity would be improved, especially when the number of companies that receive an annual cash refund in excess of $2 million is very small\(^ {27}\). To improve programme integrity at a broader level, we recommend greater compliance activity, especially for first time claimants and those seeking to obtain significant cash refunds, especially year on year.

We believe the proposed cap will only impact a small number of companies, predominately those undertaking high risk long term R&D; i.e. medical and resources. For those companies, the potential commercial returns are large and the corresponding benefit to our economy is also large (through taxes, employment and spillover). We are concerned this cap will discourage those that can locate their R&D anywhere in the world from undertaking it in

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\(^{26}\) Report, page 16.

\(^{27}\) See Innovation Australia, *Annual Report 2014-15*, page 26. While the figures are incomplete, around 100 companies claiming the refundable tax offset spend more than $5 million on R&D. Given the small number, this suggests either those claimants are at a disproportionality higher risk of non-compliance or it will have very little impact on the overall integrity of the programme.
Australia; meaning less jobs in the short term and less tax income and expertise in the long term.28

In our view, it would be better to allow the cap excess to be refundable in a subsequent year to help those companies access much needed cash. If a cap is to be introduced, it should be phased in and there should be a mechanism to allow exceptions; for instance, where a company seeks an Advance Finding or can demonstrate a long term financial benefit to Australia.

Ultimately, as more companies access the refundable tax offset, the immediate cost to Government will increase. In order to limit the cost of the refundable tax offset, some options might be:

- Phasing in a cap on the cash refund, either as an absolute (like the current $100m cap on the non-refundable offset) or as a percentage of the R&D expenditure.
- Phasing in a cap on the number of times companies can access the cash refund;
- Imposing a cap on the total amount able to be cashed out (over many years); or
- allowing companies to ‘cash out’ at a rate lower than the headline refundable rate (similar to the UK).

These would need to be modelled by Treasury to determine cost and anticipated benefit.

Report 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.*

The Report finds that additionality could be sharpened through introduction of an intensity threshold.29 We disagree. While we agree that the Incentive is designed to encourage additional R&D (additionality), we do not believe that the intensity threshold as recommended will promote this purpose, especially where it uses overall business expenses as a denominator. In fact, we believe it will be counter-productive and result in less R&D being undertaken in Australia.

We believe there is a fundamental flaw in using an intensity threshold based on business expenditure; it assumes companies with a low R&D intensity (based on total business expenditure) will spend money on R&D in Australia anyway (in the absence of access to the Incentive). An intensity approach also discriminates against ‘non-pure R&D’ companies. Industries that need our support (e.g. manufacturing, engineering, primary production, etc.) are typically not R&D intensive. The intensity threshold would mean such companies, already

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28 Feedback from companies already undertaking R&D in Australia is that they will consider moving some of their R&D offshore. Feedback from foreign companies considering R&D in Australia is that Australia is becoming less attractive with every proposed change and review of the Incentive.

under financial strain, will find it harder to invest in R&D as the relative cost goes up with no R&D offset to help defray the cost. Ultimately the intensity threshold will not achieve government policy objectives because it will erode the base level of R&D being done.

**Business as usual R&D**

While we agree most companies would (or should) spend a certain amount on R&D anyway, how and where they spend that money should be considered. A significant percentage of all R&D now relates to software based development, either directly or indirectly. Australia is not a cheap labour market, so it should not be assumed that companies will choose to undertake R&D here when it is cheaper to do so elsewhere, particularly when the R&D is not location specific (such as software based R&D). If the intention is to build Australia’s future economy, then investment in building our capabilities is needed now.

**Additionality**

At present, companies accessing the Incentive obtain a benefit in the form of a percentage of their R&D expenditure. The more a company spends, the greater its benefit in absolute terms. This volume based approach to the R&D tax incentive is considered best practice internationally. This is because in practice, it is very hard to determine where the ‘additional’ R&D comes from. The Report expects that companies undertake a base level of R&D and that only providing an R&D benefit for additional R&D will help incentivise the additional R&D. For example, if a company has 2 R&D projects, then providing an R&D benefit on a third project would, in theory, incentivise the third project (and not the first two). However, the reality is far more complex. If a company is undertaking 2 R&D projects and wishes to start another, it may be that the R&D benefit received for the first two projects part funds the third.

Further, an intensity threshold creates uncertainty for companies. As noted above, a company’s total business expenses will not be known until the end of the year; at which time it may find out that it falls below the intensity threshold and its additional work to track and prepare an R&D claim is wasted. In this situation, the intensity threshold not only fails to promote additional R&D, but may actually reduce it (as the project initiators cannot rely on the Incentive to help offset the cost of the R&D). We believe a penal regime which disallows expenditure is both discriminatory and fundamentally flawed.

Conceptually an incremental tax incentive will increase additionality; additional expenditure attracts an additional benefit. Importantly, this doesn’t disallow expenditure below a threshold but instead offers a lower base rate; thereby encouraging even low levels of R&D. However while conceptually sound, this is difficult to implement effectively. As noted by the IMF,

> “Targeting incremental R&D (above some baseline amount). Compared with tax incentives that apply to all R&D expenses, incremental incentives are cheaper

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31 This was one of the primary reasons the 175% Premium Concession under the former R&D Tax Concession failed to act as originally conceived, see findings of Nicholas Gruen as part of the Cutler Review.
because they avoid a windfall gain for existing R&D below the baseline. Such incremental schemes are used by Italy, Japan, Korea, Portugal, Spain, and the United States. However, incremental incentives can be more complex and may influence the timing of R&D investments. They also have higher compliance costs as a percentage of total support, which can reduce take-up. Some countries have therefore moved away from incremental schemes or have simplified them.32

If an incremental incentive is implemented, it will need to be done carefully and phased in over time.

For instance, if over the next 3 years, a company spends an average $10 million per year on R&D, then the first $10 million would attract a nominal base rate (e.g. a 37.5% tax offset equivalent to a 7.5% permanent tax benefit) and any additional R&D expenditure would attract a higher rate (e.g. a 40% tax offset equivalent to a 10% permanent tax benefit). Existing provisions to cap the benefit could still be applied and it would encourage companies to spend more on R&D, while providing certainty that expenditure at or below their average will still attract a base level of benefit.33

Definitions

The Report recommends that the intensity threshold be based on a percentage of the total business expenses. It is unclear whether ‘total business expenses’ includes overseas expenses, cost of sales or capital expenditure; any or all of which could radically impact the threshold and could discriminate against industries with higher running costs. It is unknown whether total business expenses is intended to relate to corporate groups whether consolidated or non-consolidated.

A company’s total business expenditure in a given year is not related to its R&D expenditure. Further, companies with high cost of sales will have disproportionately high total expenditure, meaning a threshold based on a percentage of business expenditure will also be disproportionately high. This makes it unsuitable as a measure for R&D intensity.

Additionally, companies plan R&D based on forecast cost and potential return on investment (ROI). As a company’s total business expenditure and therefore threshold amount will not be known until the end of the year, companies will not be able to factor in the potential benefit from the Incentive. This defeats the intention of using the Incentive to incentivise companies to undertake more R&D.

Decreased R&D benefit, increased administration cost

On its own, the intensity threshold will reduce the benefit available to companies accessing the non-refundable tax offset while maintaining or increasing the compliance cost. Using the example in Box 4.5, if a company spends $180,000 on R&D and has total business expenses of

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33 See also CA ANZ submission on the R&D Tax Incentive Review Report dated 1 November 2016.
$10 million year on year, then at present, it would receive a $69,300 R&D tax offset with a permanent tax benefit of $15,300. If:

- The intensity threshold is 1%, then it will receive a $30,800 tax offset with a permanent tax benefit of $6,800. This would more than halve the benefit and would be in addition to the 15% reduction due to the rate cut earlier this year.
- The intensity threshold is 2%, then the company not receive a tax offset or a permanent tax benefit.

In the above examples, the best case scenario is that the company receives a $6,800 tax offset to help offset the cost of spending $180,000 on R&D in Australia.

In the event that a company can obtain a tax offset for expenditure above the threshold, it will still need to register all of its R&D activities, even for those activities it doesn’t obtain a benefit from. Those activities will also be subject review and as a result, the compliance cost relative to the benefit will go up, not down. Where a company doesn’t reach the threshold, any time and cost spent tracking potential R&D activities and cost calculations will be wasted.

Finally, it is unclear how an intensity threshold would accommodate feedstock, clawback and other adjustments. The current $100 million expenditure cap does not accommodate these adjustments which can lead to companies being worse off for claiming the Incentive. Unless an intensity threshold is appropriately drafted, it may not accommodate this provisions to the further detriment of claimants.

Report 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.*

The $100 million cap was introduced in early 2015 and at the time it was introduced, capped the permanent tax benefit available to companies claiming the non-refundable tax offset at $10 million per year. The recent 1.5 percentage point reduction to the R&D offset rate in mid-2016 has reduced the maximum permanent tax benefit to $8.5 million; a 15% reduction.

In our view the recommendation to increase the cap beyond $100 million should not be dependent upon the introduction of an intensity threshold. As it is, companies subject to the $100 million cap have had their benefit reduced by 15% due to the rate reduction. Increasing the cap on its own would help offset this reduction and would encourage those companies to spend more on R&D. If the cap isn’t lifted, then Government could consider indexing the cap to inflation to prevent the cap effectively decreasing over time.

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34 For instance, increasing the cap to $120 million would limit the maximum permanent tax benefit of $10.2 million.
Report 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.

Current administration of the Incentive is inefficient, inconsistent and costly. The Government has estimated that the annual administration cost by industry alone is $3 billion, although we believe this estimate doesn’t take into account feedstock and other adjustments and subsequent recovery of costs through taxes on income, dividends, disposal of R&D results, etc. Nonetheless, we welcome any measure that will improve the efficiency of the programme and reduces the cost of administration.

Single registration form

Currently R&D expenditure is claimed through the income tax return. Income tax return forms are not well suited to the inclusion of R&D activity descriptions. However if companies are not required to submit a description of their R&D activities, it will increase the risk of non-compliance. Therefore if descriptions are required, then it would make more sense for the R&D registration form to include the R&D tax schedule and be lodged together, probably with the ATO.

At present companies must register their R&D activities within 10 months after the end of the relevant income year. If one application form is used, this will require companies to finalise their R&D expenditure calculations by the deadline. If the company has already lodged its income tax return, then the R&D registration would amend the income tax return. If the company has not yet lodged its tax return, then even if it could submit the application (including R&D tax schedule), the claim would not be processed by the ATO until the income tax return is also lodged. Thus using a single registration form may reduce the administrative cost slightly, but won’t change company behaviour by bringing forward the time at which the company makes a claim.

Transparency

The Report suggests publishing the names of companies claiming the R&D Tax Incentive and the amounts of R&D expenditure claimed. We agree, but note there may be some commercial sensitivities around publishing details of company R&D activities.

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35 Application of the R&D tax offset requires information contained in the income tax return (e.g. taxable income or loss and carry forward losses).
Conclusion

We are pleased Government recognises that Australia’s ability to innovate is critical to our future prosperity. The Incentive has long been a primary support for industry based innovation, and its increasing uptake is evidence of an effective programme, but concerning for its long term fiscal viability.

As a result, Government is faced with a number of difficult decisions, in particular:

1. How much should it spend as a percentage of GDP on supporting innovation by industry?
2. What form or forms should that support take (that will deliver the best return on its investment)?

Any review of the Government’s support for industry innovation should seek to balance its legitimate concerns around the cost of that support (in foregone tax revenue) with the benefits received by the Australian economy, including increased productivity. Countries like France provide good examples of how government policy has led to increased innovation by industry.36 Government should also be conscious that innovators in industry need to be confident in the policy soundness underlying any changes to the R&D tax incentive, which must be implemented in a form that promotes business certainty and, as far as possible, avoids increased complexity and associated compliance costs.

Overall, we agree in principle with most of the recommendations, recognising that further work is required in relation to the form in which they should be implemented and their practical operation. We believe Government should:

1) develop clear guidance, including industry case studies which illustrate how companies identify activities as eligible R&D activities and also ineligible activities, along with examples of contemporaneous documentation that supports the R&D claim;

2) implement a collaboration premium, but consider reducing and capping the benefit so that it can be accessed by more companies;

36 France doubled its investment in R&D tax credits from €1.4B in 2006 to €3B in 2008 which led to a corresponding increase in business investment in R&D.
3) implement a cap on the refundable tax offset, but consider increasing the amount and/or allowing exceptions where the R&D meets certain additional criteria (e.g. National Benefits Principles);

4) reject any intensity threshold that excludes expenditure below the threshold or which is based on a metric unrelated to R&D (i.e. total business expenses), and consider an incremental based approach;

5) consider lifting the $100 million cap to take into account the recent 15% reduction in the R&D benefit for larger companies (from 10% to 8.5%);

6) increase regulator review activity to improve compliance by both taxpayers and their advisors, and consider an R&D advisor and assessor accreditation program;

7) consider mechanisms to contain the long term cost of the program, especially in relation to its greatest cost component, the refundable tax offset;

Finally, we note the impact of the offset rate reductions passed into law earlier this year, including the effect on R&D investment by industry, were not included in the Report. We believe this should be assessed when considering which of the recommendations should be implemented, the form any changes should take, and the timeframe for implementation.