

IRU's response to the Government's National Innovation and Science Agenda

Submission 2: Research & Development Tax Incentive Review

The Innovative Research Universities (IRU) supports the Government's National Innovation and Science Agenda, with its 24 useful measures to transform Australia's approach to innovation. The challenge ahead is for all involved to respond positively to the new incentives, raising the level of industry driven research and increasing investment in bringing research outcomes to market.

IRU will contribute to the development of the Strategy, looking to ensure that programs will encourage investor action without stifling opportunities through overly strict rules or exclusion of potential future activities.

1. The Research & Development Tax Incentive

The 2011 revamp of tax support for investment in research and development has led to a sharp rise in claims, growing to almost \$3 billion in 2013-14. There are concerns whether all the forgone revenue is serving its purpose to encourage additional Research and Development to support an innovative economy. The task of the Review is to render the incentive more effective through sharpening its focus.

The Issues Paper is useful in giving a snapshot of the current settings and performance of the Research and Development Tax Incentive, placing it within the NISA context and acknowledging that the surging cost of the incentive "make it important that the effectiveness of the programme is assessed in the context of the broader suite of innovation measures." The money that the government foregoes is its largest single contribution to Research and Development (just under 30%).

To date, the Research and Development Tax Incentive has operated as a stand-alone incentive largely decoupled from the government's parallel investment into Australian research. The Review is an opportunity to tie together the major elements of Government support for research and development, the essential underpinning for innovation.

Maximise the potential of the Research and Development Tax Incentive by coupling it to the government's investment in research with the outcome of greater levels of business innovation through an increased focus on industry driven research in Australia.

2. Improving the outcomes from the Research and Development Tax Incentive

The objective of the Research and Development Tax Incentive is to support industry to conduct Research and Development activities that might otherwise not be conducted (additionality) and which are likely to benefit the wider Australian economy and community (spillovers). Change is needed to increase the spillover effect and to strengthen confidence that the research claimed is legitimate.

Strengthening the incentive for Research and Development carried out through research bodies

The vast majority of research and development supported through the incentive is for activity within the company. Only 9.5% of total projects registered indication collaboration with another organisation such as a university. With the level of interaction between business and research bodies low in Australia and also very few researchers employed outside of universities and other

research agencies, we need to strengthen the incentive to bring the two together, consistent with NISA's stated aim of increasing collaboration between researchers and industry.

One element of spillover comes from companies not currently engaged with research and development being led to do so by the evidence that their competitors are both gaining Government support and reaping the benefits from better products and services. If initially companies inclined to Research and Development benefit, the longer-term outcome is to pull others in.

There are two ways that the Research and Development Tax Incentive can be improved to drive greater collaboration between industry and research:

- providing a more beneficial tax benefit for Research and Development carried out through research bodies, along the lines of the distinction now in place for smaller companies; or
- as previously proposed by the IRU (*Industry Driven Research*) providing a direct subsidy to business using researchers from universities and other agencies, with the tax incentive remaining for primarily for Research and Development carried out in house. The subsidy could be paid
 - on top of the incentive, so that all Research and Development is still claimed for the tax incentive, or
 - instead of the incentive, such that a company's Research and Development would be split between one or other benefit but not be claimed for both.

A further variant is the argument from Professor Bruce Chapman that Government support be in form of a loan repaid from future profits which would both encourage investment and contain long term cost to Government.

Providing a direct subsidy might be simpler than adding a further differential to the current system.

The Issues Paper makes clear that few OECD countries (Australia, Canada and Netherlands) use tax measures as the principal form of support for business Research and Development with more countries supporting business Research and Development through direct measures (e.g. Finland, Germany, New Zealand and Sweden). Of these, three rank highly for the proportion of businesses that collaborate with research institutions on innovation including Finland, which is first. New Zealand however ranks closer to Australia and Netherlands with low to medium levels of collaboration.

Encouraging industry funded research through recognised research bodies also increases confidence that the research claimed is real, maintaining the legitimacy of the tax incentive and any subsidy.

Provide a more beneficial tax concession for Research and Development carried out through research bodies or provide a direct subsidy to business for using external Research and Development through research bodies.

Targeting eligibility

Currently the Research and Development Tax Incentive provides a refundable 45% tax offset for companies with turnover of less than \$20 million and a non-refundable 40% tax offset available to other companies. At 20 cents per dollar of Research and Development registered for small firms, Australia's tax subsidy for small firms is more generous than the OECD average of 15 cents per dollar.

- The advantages for smaller companies make sense and should be retained. The 'refundable' component, meaning that companies receive an immediate refund, is indispensable for companies of this scale. One Melbourne-based company which has a very successful collaboration with IRU member James Cook University described the Research and

Development tax concession as critical, an element without which their endeavour would not have gone off the ground. Read more about the example [here](#).

- Larger Australian firms should continue to receive support. They may appear large in the Australian context but against the international markets most companies operate in they are not. The \$100 million cap on benefits introduced in 2015 ensures an overall limit to the benefit that any one company can receive.

The OECD argues that Research and Development Tax Incentives should be designed to primarily meet the needs of young, innovative and stand-alone firms without cross-border tax planning opportunities. While there is logic in restraining businesses with multiple national bases taking advantage of cross tax arrangements, we need to ensure we support export-focused businesses which should not be disadvantaged.

Retain working elements of current settings while ensuring that export oriented firms are not disadvantaged.

The case for Social Sciences, Arts and Humanities

Currently research in social sciences, arts and humanities is not eligible for support through the Research and Development Tax Incentive. Such a blanket exclusion of the areas that underlie the creative and knowledge industries which are predicted to be at the forefront of future growth is foolish.

The test should be the relevance of the research to the business of the company. Where a company wishes to invest in social sciences, arts and humanities to improve its services and products it should be eligible.

Include research in social sciences, arts and humanities, where it meets standard tests of being a core Research and Development activity directly relevant to the business's future development.

3. An efficient user-friendly application process

The current process does not encourage companies to become research active looking for research based innovation.

Businesses spend more than \$199 million paying consultants to enable businesses to benefit from the tax concession. This is around 4% of the tax benefit returned and about 1% of the eligible Research and Development. The application process should not be so complicated that it requires such support for companies to register and make a claim.

The Issues Paper explores whether companies should register in advance of undertaking research and development, rather than wait until they do engage in Research and Development sufficient to justify making a claim.

To support the Government's objectives to increase the extent of innovative companies should be encouraged to register on the basis that research and development should be a standard part of their operation model.

Encourage companies to invest in research and development through promoting registration for access to the tax incentive and any direct subsidy

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