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Business Tax Working Group Secretariat
The Treasury
Langton Crescent
PARKES ACT 2600

Dear Sir/Madam

BTWG Proposals

CSL Limited is pleased to present this submission in response to the Business Tax Working Group (BTWG) Discussion Paper released in August 2012.

The CSL Group has a combined heritage of outstanding contribution to medicine and human health with more than 90 years experience in the development and manufacture of vaccines and plasma protein biotherapies.

CSL Limited is an Australian listed company with global reach and a market capitalisation of $22bn. Uniquely for a global biopharmaceutical firm, CSL is headquartered in Australia and undertakes a substantial proportion of R&D in Australia. CSL spent $355m on its global R&D programs in 2011/12 and expects to increase this to $400m this year. Currently, more than half of CSL's R&D expenditure is undertaken by our Australian operations.

As a global company, CSL believes in the importance of maintaining incentives for companies to do business in Australia by ensuring consistency in government support for industry innovation through the taxation system.

The BTWG has recommended, amongst other things, several proposed changes to the new R&D tax incentive. In essence, the BTWG targets fiscal savings through reducing or eliminating R&D tax incentive (& other) benefits for larger companies.

Tax Base Broadening

The Australian Government has constrained its brief to the BTWG such that any cut to the company tax rate must be accompanied by measures that fully offset the cost by broadening the business tax base. The logic for doing this is unclear and is inconsistent with the conclusions of the Henry Report which said (AFTS Review (2009), *Final Report to the Treasurer*, Treasury, Canberra):

> *"The company income tax rate should be reduced to encourage investment in Australia, particularly highly mobile foreign direct investment. In the long-run this would increase income for Australians, by building a larger and more productive capital stock and by generating technology and knowledge spillovers that would boost the productivity of Australian businesses.*

In the long-term, a larger and more productive capital stock would not only result in higher growth but is also likely to result in higher wages. A lower company income tax rate would also reduce incentives for foreign multinationals to shift profits out of Australia."

Reducing the company tax rate will be its own reward for Australia in the medium to long term. There is no need to "compensate" by base broadening or reducing tax concessions because the rate reduction on its own will be economically positive to Australia. This is clearly outlined in the Henry Review and widely accepted by most economic commentators.

CSL's R&D Footprint in Australia

Despite a significant offshore presence, CSL has consistently demonstrated a preference for directing R&D investment to Australia. In 2011/12, we invested A$355 million in R&D globally and employed over 900 people in R&D activities world-wide. Furthermore, CSL is building new R&D facilities in Australia, including a world-class recombinant biotechnology facility as part of an A$300 million expansion at our Broadmeadows site in Victoria.

CSL's research and development activities are conducted at three facilities located in Victoria at Bio21, Parkville and Broadmeadows. These facilities support our core licensed product businesses and the development of new protein-based therapies for unmet medical needs. We focus on products that align with our technical and commercial capabilities which includes:

- Immunoglobulins: Supporting and enhancing our portfolio of intravenous and subcutaneous immunoglobulin products and developing new products with greater convenience for patients.
- Specialty Products: Expanding the use of specialty products through new geographical markets, medical indications and/or modes of administration.
- Haemophilia/Coagulation: Supporting and enhancing our current portfolio of plasma products and developing new recombinant products focusing on patient convenience.
- Breakthrough Medicines: Developing new protein-based therapies to address significant unmet medical need.
- Influenza: Identifying new product opportunities, providing specialist technical support and research activities to identify the cause of reported febrile events associated with influenza vaccine in paediatric patients.
- Licensing: Partnering activities that maximise the value of our Intellectual Property, such as our proprietary ISCOMATRIX® adjuvant.

CSL's investment in R&D in Australia is now one of the largest across industries; we employ highly qualified scientists and create a pool of talent that spreads well beyond our own operations. We have generated products, such as Gardasil®, the world's first vaccine against cervical cancer, that have made CSL a world leader in its field, as well as intellectual property that has returned hundreds of millions of dollars to Australia. CSL's activities flow-on to affect a range of other Australian businesses (a 2009 study identified A$1.6 billion of spill-over benefits from CSL's Australian operations).

Research and development has been, and will continue to be, a critical growth driver for CSL. Over the past 5 years, we have almost doubled our R&D investment. As a result we have a significant number of product candidates moving through the clinical development phase over the next 5-10 years. This is the most complex and expensive stage of product development.

While CSL has consistently demonstrated a preference for directing R&D investment to Australia, the current business conditions in Australia making this very difficult to continue to be the case. If the current R&D tax credit scheme were wound back or abolished, CSL, like many other organisations, would be forced to reassess its R&D strategy and the outcome is likely to be dire for its local activities and indeed for R&D in Australia. Given its history, CSL has an extremely strong and mutually beneficial relationship with the Australian medical research community which would also be in jeopardy if CSL is forced to reconsider its Australian based R&D operations.

R&D Tax Incentive

The current R&D tax incentive was introduced with effect from the 2012 year of income after four years of consultation between government and industry. CSL is concerned that such significant changes are being proposed to the R&D tax incentive so soon after its implementation.

Given the economic challenges faced by companies operating in the Australian market, CSL believes that reducing the benefit of the R&D tax incentive will be a disincentive to locating innovation activities here. This is a particularly relevant question for multinational companies who have alternative offshore sites readily available for R&D activity.

As the BTWG Discussion Paper acknowledges, governments support R&D activities because of the positive benefits they generate for the wider economy. The R&D tax incentive has many positive features:

- It encourages companies to carry out genuine product development and process improvement projects beyond 'business as usual' activities. This promotes value adding by larger Australian businesses, creates spin-off benefits through the supply chain and leads to a more knowledgeable and skilled workforce.

- The recently introduced R&D tax incentive has a tighter definition than the previous scheme so that only core R&D activities or those with a dominant purpose of supporting core activities can be claimed. As the new R&D tax incentive has only been in place for a short time, the effect of this more focused definition has yet to be demonstrated.
- Industry sector improvements to performance through technology often require significant recurrent and capital investment by large companies.

CSL has contributed to the discussion on support for R&D over the years and consistently advised Government that government support is of great importance when considering those major new investments around which CSL will structure many of its forward R&D activities. CSL reiterates its firmly held belief that Government needs to maintain an incentive to attract or retain in Australia R&D projects or investments that are genuinely 'footloose' (i.e. easily capable of being carried out anywhere). We expect this applies to any firm that has significant high risk later stage R&D programs, those which tend to be most costly and most valuable to the economy.

Alternative 'R&D intensity' threshold test

As indicated above, CSL rejects the need for base broadening of the tax system to pay for any company tax rate cut. In particular, CSL maintains that any reduction in the R&D tax incentive will be unfavourable to the Australian economy.

However, CSL recognises there may be some companies that claim the R&D tax incentive who are not motivated at all by that incentive and that the incentive has no bearing on their decision as to whether and where the R&D activity should be performed. Put simply, the R&D tax incentive is wasted on them. CSL would not object to a threshold test if one could be developed to satisfactorily eliminate these types of "nuisance" claims without harming those companies who do perform valuable R&D activities in Australia.

In informal consultation with other companies and associations, the idea of an 'R&D intensity' test has been raised as a possible solution. The idea of this test would be to identify all companies who carry out valuable R&D and ensure they remain eligible for the existing R&D tax incentive, the rules for which would not otherwise change.

We think that the measure of R&D intensity should be based on the value of the eligible R&D expenditure as defined under the current scheme. The value of this expenditure should then be compared to a measure of the size of total activities performed in Australia by the organisation and we believe the best measure is that of the Total Revenue From Continuing Operations, as defined by Australian accounting standards.

This activity-based measure is a better than, say, an asset or wealth value. Turnover is chosen to ensure that small start-up R&D enterprises with low turnover would remain eligible. In their case an alternative measure against, for example, asset values would not be appropriate, particularly if in start up phase their R&D activities are low but their financial resources to fund future R&D activity are relatively large.

A threshold percentage would then need to be determined as an acceptable benchmark. We would suggest 5%. Consequently, companies that do not expend at least 5% of Total Revenue on eligible R&D expenditure would not satisfy the test and therefore would be ineligible to claim an R&D tax incentive for that financial year. Companies that do pass this hurdle would be able to claim the R&D tax incentive under the current scheme.

We are of the strong view that cuts to R&D incentives for large businesses will stifle the development of innovation in Australia. It should be remembered that there was a significant drop in Business Enterprise R&D spend in Australia when the rate of incentive was halved in 1996. There is an even higher level of global mobility today and the Australian currency is much stronger. Greater incentives in other jurisdictions, compared to the late 1990's could lead to a transition of innovation away from Australia which we may struggle to reverse in the future. Notwithstanding our possible acceptance of an 'R&D intensity' type threshold test, we believe strongly that the current R&D tax incentive should not be changed.

In summary, it is CSL's view that:

- Company tax should be reduced independently of the treatment of R&D concessions as any company tax reduction will be more than self funding in the medium to long term,
- In any case, no changes should be made to the new system of R&D incentives which have only recently been put in place and,
- Reducing or abolishing the R&D incentive will see footloose R&D activities lost to off-shore countries and risk the further development of innovation in Australia.
- It may be possible to improve the efficiencies of the current R&D tax incentives through the introduction of a R&D intensity test.

Should you have any questions, we would be happy to discuss this further.

Yours sincerely

Gordon Naylor
Chief Financial Officer