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Dear Joshua

Submission on Exposure Draft R&D law and explanatory materials

Chartered Accountants Australia and New Zealand (CA ANZ) appreciates the opportunity to provide our submission on the [Exposure Draft R&D law and explanatory materials](#) (the Draft law), released on 29 June 2018.

The Draft law implements the R&D changes announced in the Budget 2018/19, in which the Government formally responded to recommendations made by the R&D Tax Incentive Review Panel (Review Panel), chaired by Mr Bill Ferris AC (Innovation Australia), Dr Alan Finkel AO (Chief Scientist) and Mr John Fraser (Secretary to the Treasury). The Review Panel was asked to “identify opportunities to improve the effectiveness and integrity of the R&D Tax Incentive, including by sharpening its focus on *encouraging additional R&D spending* [emphasis added].”

We wish to reiterate at the outset that CA ANZ strongly supports the R&D Tax Incentive as an important broad-based policy instrument to encourage investment in R&D in Australia. It assists in creating long-term value through supporting innovation, and as such its success, stability and sustainability is vital for the future prosperity of Australia.

As our primary concern with the Draft law is the R&D intensity measure - both the policy and implementation aspects – this submission is primarily focused on this significant proposed change.

This submission provides three categories of comments:

1. High level remarks on important policy choice aspects that should be addressed;
2. Specific comments on the tax law design aspects of the Draft law; and
3. Responses to the Consultation questions on R&D intensity.

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1. High level remarks on policy choice aspects – R&D intensity

1.1 R&D intensity gap as a policy target

The studies on R&D intensity sound a warning bell for policy-makers who are considering the adoption of R&D intensity as the measure on which to reward and encourage private R&D investment with public R&D support. Three key points of caution can be drawn from the literature:

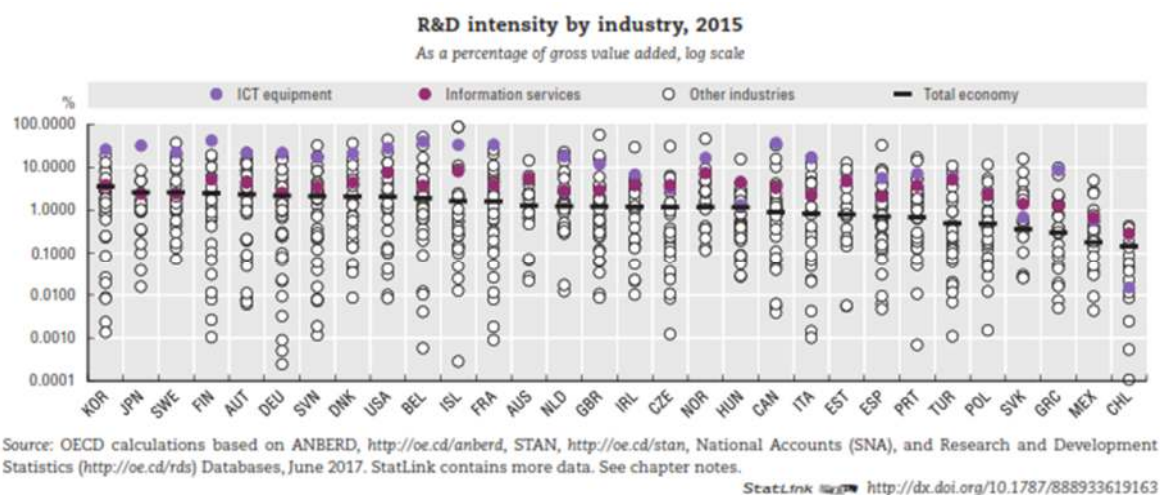
- (i) R&D intensity deficiencies cannot be rectified by policy intervention if the cause is structural. While R&D intensity can be improved if the cause is intrinsic underinvestment in particular industries within an economy, if the deficiency in an economy is structural in nature, then the adoption of R&D intensity metrics will do little to increase the country's R&D intensity.¹ For example, this has proven to be the case for the European Union (EU) economies over a long period of time, in contrast to the United States (US) and Japanese economies which are high-tech economies, heavily weighted with Information and Communication Technology (ICT) sector companies.

The OECD has identified that Telecommunications and IT services rank consistently at the top in terms of digital intensity, while Agriculture, Mining and Real estate are consistently at the bottom in terms of their degree of digital transformation and digital intensity.² The OECD also notes that the headquarters of the top 2000 R&D corporations worldwide are concentrated in just a few economies – notably the US, Japan and China – with 70% of their total R&D spending concentrated in the top 200 companies.

The following chart provides an illustration of the sectoral composition of Australia's economy, and the relative R&D intensities of these sectors, comparing digital with other industries.

¹ Pietro Moncada-Paternò-Castello (2016), [A review of corporate R&D intensity decomposition](#), Solvay Brussels School of Economics and Management, iCite Working Paper 2016 – 018, at p.22-24.

² OECD (2017), [OECD Science, Technology and Industry Scoreboard 2017](#), at p.14.



The ICT equipment sector in Australia seems to be non-existent (an economic structural issue), while the R&D intensity of our Information services sector seems high already relative to most other OECD countries. Similarly, the average R&D intensity of our economy as a whole is above average, with no outlier sectors that are very low intensity, compared with other countries.

CA ANZ contends that Treasury must undertake a robust analysis of Australia's economic composition to determine whether our economy is one which is capable of responding to the proposed ambitious R&D intensity parameters, or alternatively, whether Australia's economy is one whose structural composition means that any R&D intensity measure will be incapable of achieving the goal of increasing the relative intensity of Australian corporate's R&D expenditure. We anticipate that the Australian economy is much more akin to the EU composition, than the US/Japanese composition.

To fail to do this analysis and assessment before adopting the proposed R&D intensity measure would be to risk implementing an economically futile policy target, and much worse, in pursuing that target, would potentially jeopardise the existing 'additionality' that is achieved by the R&D program.

- (ii) R&D intensity as a policy target, and comparisons of corporate R&D intensity ratios between different economies, should "be handled with care".³ In particular, the interpretation of and reliance on R&D intensity data as a policy target is cautioned against as it does not capture or speak to many other indicators of good quality or desirable R&D, such as efficiency of R&D, effectiveness of R&D, technological quality, business strategy, leadership, competitiveness, etc.
- (iii) R&D intensity is a long-term metric which should be used to monitor R&D across the economy, not a short-term metric as there are more appropriate indicators at a lower level that should be developed by countries.⁴ The denominator of R&D intensity is typically in GDP, or sales or value added. The 2017 OECD report '*Main Science and Technology Indicators*' shows that Israel has the highest R&D intensity globally of 4.25% R&D expenditure to GDP, while the EU area remains at 1.94%.⁵ However, it must be remembered that Israel's intensity levels have been achieved at the expense of a broad-based incentive such as Australia's, by favouring a higher proportion of State-selected projects by way of direct grant funding.⁶

³ Pietro Moncada-Paternò-Castello (2016), [A review of corporate R&D intensity decomposition](#), at p.23.

⁴ Rindicte (2008) "[A Time Series Analysis of the Development in National R&D Intensities and National Public Expenditures on R&D](#)", Brussels, at p. 5 and 35

⁵ OECD (2018), OECD [Release of Main Science and Technology Indicators - Latest estimates of R&D investment in OECD and major economies](#), MSTI 2017/2 (March 2018).

⁶ OECD (2017), OECD [Measuring Tax Support for Innovation](#), OECD Publishing, Paris.

The important point to note, whatever the funding approach, is that the OECD research reveals that generally “across countries, R&D intensity in the business sector has a positive correlation (0.3) with the level of government support to business R&D”.⁷ That is, generous public R&D investment is needed to induce productive flows of private R&D investment.

As noted above, the stated aim of the R&D Tax Incentive Review was to “improve the effectiveness and integrity of the R&D Tax Incentive, including by sharpening its focus on encouraging additional R&D expenditure”.

We recommend that Treasury carefully guide and advise the Government on this major tax law design change to the R&D Tax Incentive as the proposed R&D intensity measure for the non-refundable offset has the potential to severely undermine the R&D program objectives of achieving spillover benefits for the Australian economy. We expect that the R&D intensity measure as proposed would likely achieve the exact opposite of the Government’s express remit to the Review Panel of “encouraging additional R&D expenditure”, due to existing participants rejecting and dropping out of the R&D program. We discuss the reasons for this expectation in greater detail below.

1.2 R&D Premium rates - International competitiveness and viability

In our view, the policy decision to offer an entry level R&D benefit rate of 4c/\$ is an exercise in futility and a patent disregard of the reality of the globalised world in which we live and conduct business. CA ANZ understands that this rate, if enacted, would be amongst the lowest R&D offerings by any country in the world. In OECD countries, the mean R&D tax subsidy rate for large companies is estimated at 10c-13c/\$.⁸ Accordingly, the first two proposed R&D benefit rates of 4c/\$ and 6.5c/\$, which are a fraction of the OECD average, are not internationally competitive in themselves. Indeed a 4c/\$ R&D benefit is below the viable rate of incentive, which is widely regarded as 5c/\$ minimum having regard to standard compliance and administration costs.

However, when you add on top of that:

- (i) the R&D Premium intensity calculation compliance obligations to access that rate; and
- (ii) the higher R&D benefit marginal rates of 6.5c/\$, 9c/\$ and 12.5c/\$ respectively apply only to incremental expenditure; and
- (iii) the R&D intensity rates of 2<5%, 5<10%, and 10>% respectively are inordinately ambitious or impossible to achieve in order to access the higher R&D benefits;

the R&D incentive becomes a clear non-incentive, or indeed a disincentive from participating in the R&D program in Australia for those companies who would only qualify for the two lower end benefits. This is because the net R&D benefit is considerably lower after compliance costs. The reward is not worth the cost and the risk to obtain it. This issue of a ‘viable rate’ is discussed in more detail below, under 2. Specific comments.

By comparison, [New Zealand has announced](#) that it will introduce a simple, generous R&D Tax Incentive from 1 April 2019 which will provide a 12.5c/\$ R&D benefit on every dollar of R&D expenditure (volume-based), not merely on a small, incremental amount of the total R&D expenditure. This may result in the outcome that where new R&D activities can be undertaken in New Zealand they will be, to the detriment of Australia’s economy.

⁷ OECD (2017), OECD Science, [Technology and Industry Scoreboard 2017: The digital transformation](#), OECD Publishing, Paris.

⁸ OECD (2017), OECD [Review of National R&D Tax Incentives and Estimates of R&D Subsidy Rates](#). See p.26 and Table 13.

2. Specific comments on tax law design aspects of the Draft law

2.1 R&D Premium – Good tax law design principles

From the perspective of good tax law design principles, the R&D Premium intensity mechanism proposed in section 355-100(1A) falls short on all counts, namely, Simplicity, Efficiency, Equity, and Certainty.

- Simplicity** – the R&D Premium table consisting of four (4) rates and corresponding intensity thresholds to be applied on a sliding scale to incremental R&D expenditure falling within those bands, after calculating those expenditure amounts by applying a formula reflecting R&D intensity percentages through a highly complex and ambiguous definition of “expenditure”, could hardly be more complex for business to comply with. The other side of that coin is that it could hardly be more complex for the ATO, as regulator, to administer, verify and enforce. The interactions between the proposed R&D intensity calculation and a myriad of business costs including tax liabilities will be many and varied. These taxes could include customs duty, stamp duty, payroll tax, FBT, Superannuation guarantee, and potentially significant transfer pricing adjustments, each of which will involve their own questions of law. With complexity often comes unforeseen and unintended consequences. This means that the R&D intensity calculation is inherently volatile as it is subject to a wide range of adjustments, retrospectively, in any given year. We consider that there are too many moving parts for the formula to provide an appropriate, workable basis for granting a broad-based, incentive to business, particularly one that is so economically critical to Australia’s future prosperity.
- Efficiency** – the entry level R&D benefit of 4c/\$ offered to larger companies (\$20 million or > turnover) is vastly different to the entry level R&D benefit of 13.5c/\$ offered to smaller companies (<\$20 million turnover), creating a significant, distortive effect and disincentive to growth for companies close to the threshold crossover. The large gap in the relative offerings should be considerably narrower to smooth out the ‘cliff’ between the two categories. Also as noted above, another aspect of inefficiency is the regulatory cost of resourcing the administration and enforcement of the R&D intensity calculations that apply to every single claimant of the non-refundable offset. We anticipate that it will be completely unworkable and un-administrable in practice. In our view, the R&D Premium’s complexity is simply not fit for purpose in the R&D program. Why would the Government choose to introduce such an inefficient model for a subsidy that is meant to be a clear, attractive incentive for honest business, and a deterrent for dishonest business to claim? It seems to achieve the opposite. Such complexity will create a new integrity risk for the R&D program as potentially inaccurate claims will be very difficult for the ATO to have the bandwidth to audit, detect and successfully enforce in Court.
- Equity** – the R&D benefit available to larger companies is \$0c/\$ (zero) without having to undertake the onerous R&D intensity calculation. By contrast, the R&D benefit available to smaller companies is 13.5c/\$ without having to demonstrate any R&D intensity. This is highly unfair to large companies. There should be some R&D benefit offered to larger companies in the base R&D rate in subsection 355-100(1). At a minimum, the base R&D rate should be the corporate tax rate, plus the entry level rate which should be removed from the R&D Premium table. We discuss this in greater detail under the Recommendations below, including what we consider should be the minimum entry rate for the non-refundable offset if it is to have a chance of remaining competitive.
- Certainty** - the R&D Premium formula involves a great deal of inherent uncertainty as business will not know their total expenditure until year end. It is not something that can be known with certainty at the beginning of the year. Even after year end, the expenditure number could retrospectively change if there was a material adjustment, creating a risk of over-claim and penalties. On the other hand, a significant transfer pricing adjustment made by the ATO to an Australian entity’s income tax expenses could in fact

inadvertently push a claimant into a higher R&D benefit band. It seems to us that the complexity of the R&D Premium formula is fraught with uncertainty for business and regulatory risk to the revenue. The inability for all sides concerned to plan for and have line of sight over the quantum of R&D claims is an undesirable and imprudent situation to bring about.

2.2 Leveraging the natural systems and processes of business

Both the ATO and the Government are promoting the transition towards digital services, and they recognise that the demand for digital transformation is increasing. For example, in the ATO's [Operational Framework for Developers and Service Providers](#), it is stated that “the community expects to leverage their natural systems and interact with government through software solutions.” The ATO acknowledges that the Government is investing in digital service offerings, through Standard Business Reporting (SBR) and by publishing ATO Application Programming Interfaces (API).

Despite the Government's stated policy objective of simplifying and streamlining the tax laws so that they are capable of digital transformation and automation to achieve compliance and administration efficiencies, the proposed R&D intensity mechanism represents complex tax law design that seems to be going in the entirely other direction. Calculation of the R&D Premium for all large businesses will be a technical, complex, guidance and advice-heavy process, and therefore a costly compliance burden on those business. In turn, it will have a similar impact on the ATO's resources as regulator. This will necessitate increased use of and reliance on professional advisers, and ATO guidance in order for business to access the incentive, not reduced reliance. Furthermore, the detailed calculations, spreadsheets and supporting workpapers that will be involved will in no way leverage the natural systems and processes of business. A new, special R&D intensity calculation will be required.

Meanwhile, we understand that one of the Government's stated aims was to improve the R&D Tax Incentive to ensure that businesses were able to keep more of the R&D incentive dollars paid out of the R&D program funds, through achieving lower compliance costs. The R&D Premium, as a modernisation of the tax law incentive, should be designed in a way that improves its ability to increase two-way data flows, where information is pulled down from the ATO through software. Instead, we consider that the complexity of the R&D Premium will likely curb any such potential, with the result that for the R&D tax incentive, business will remain increasingly reliant on the traditional 'inbound' data flows (e.g. lodging forms to the ATO), prepared by R&D advisers and consultants.

We urge Treasury and the ATO to reconsider the R&D intensity concept and drafting of the R&D Premium, in light of the Government's and the ATO's own broader digital transformation vision and agenda for Australia's tax system.

2.3 R&D Premium – Basic Goal setting principles

If the Government is seeking to give business a target or goal to achieve, namely increasing their R&D expenditure in a meaningful way, the policy adopted to implement that should meet good goal-setting principles, for example SMART principles. That is, objectively assessing the R&D Premium and intensity rules, they should establish a goal for business that is Specific, Measurable, Achievable, Relevant and Timely. However, on our assessment, the R&D intensity mechanism under the R&D Premium does not meet these basic principles of good goal-setting.

To our mind, the current tax law design of the R&D Premium does not meet any of these principles, other than perhaps Specific. The rules are quite specific, with the table of rates, and percentages, and legislative formula (although not at all certain as to what it is specifying). However it is most definitely *not*:

- Measurable – it is extremely complex, ambiguous and costly to measure and quantify. This is largely due to the definition of “expenditure” which includes both tax law and accounting concepts, thereby potentially double counting, and creates an asymmetry

between the denominator and the numerator which only includes tax law concepts. The measure is therefore not comparing apples with apples, but contains a skewed and inflated denominator.

- **Achievable** – it is extremely difficult to meet or exceed the 2% threshold in order to get into the second incremental rate of 6.5c/\$, which is still likely to be unviable given the onerous compliance costs involved in complying with the R&D intensity calculation. We understand from member feedback that most companies are likely to have an R&D intensity under the proposed rules in the range of 0%-1%. We are aware of preliminary modelling done by highly experienced R&D practitioners which indicates that R&D intensity of over 13% would be required under the R&D Premium in order to be better off than under the existing R&D Tax Incentive's 8.5c/\$ volume-based offering.
- **Relevant** – the R&D Premium mechanism is arguably not adapted or relevant to the question of whether a firm is conducting high value or high calibre R&D, for the various reasons discussed above. There are many more appropriate indicators of desirable R&D for an economy than the amount of money thrown at solving a problem or at creating new things or ways of doing things. Indeed, overspending may be an indicator of inefficiency and lower competence, than the converse assumption.
- **Timely** – the R&D intensity rules hinge on metrics that are only known after the year end, so the R&D intensity goal cannot properly be pursued in a timely manner. Significant amendments to the definition of "expenditure" may enable the timing aspect to be improved, e.g. by applying a 3-year rolling average, which is based on the prior years' data, not current year.

2.4 Modelling of R&D Premium 'intensity' mechanism

Given the complexity of the proposed R&D Premium intensity calculations, Chartered Accountants ANZ believes that it would be very difficult for Treasury to have accurately modelled the likely impacts of the R&D intensity thresholds. We have a great deal of empathy for Treasury in this regard, given that our CA members, as professional accountants, have found it extremely challenging to attempt to work through preliminary worked examples of what is required by the calculations. We have even greater empathy for all of the businesses who will have to deal with these new rules once implemented.

This does not bode well firstly for being able to forecast and assure ourselves of the likely economic impacts of the proposed changes, nor for our shared future of having to comply with and implement the intensity mechanism in practice as an integral part of the R&D Tax Incentive for all claimants of the non-refundable offset going forward.

If the R&D Premium is to be proceeded with, we recommend that Treasury ensure that the mechanics of the R&D Premium rules that are ultimately adopted are sufficiently simple to be capable of nuanced and calibrated modelling so as to obtain a level of comfort around the likely real world impacts of the new rules. Until this can be done, we believe that the Government is taking a considerable risk in making this change to the non-refundable offset, as the new R&D Premium rules represent the most far reaching and potentially damaging policy change to the R&D Tax incentive in the long history of the R&D program.

2.5 Suggested amendments to R&D Premium intensity mechanism

If the Government decides to proceed with the R&D Premium intensity mechanism, we recommend that Schedule 1 of the Draft law be amended and re-designed as follows:

- Clause 7 - Subsection 355-100(1): "the R&D entity's *corporate tax rate for the income year, plus [entry level rate of benefit]."

This will provide better symmetry with Clause 6 which sets out the R&D rate for smaller companies. This is consistent with Finance Minister Scott Morrison's acknowledgement in

his [Budget media release](#) that the Premium “has been developed in recognition that many larger companies undertake research and development and that this should be afforded a baseline level of support, but stronger incentives are required for them to increase their overall R&D intensity.”

We recommend that the entry level rate of benefit be no lower than the second proposed tier of 6.5%. We recommend that the 4% rate be deleted entirely as it is an unviable, non-incentive that would likely cause the program to be abandoned.

This amendment would achieve better equity, certainty of the base rate of support, remove the R&D intensity compliance obligation for the base rate of support, and would narrow the distortive gap in the benefit available to larger versus smaller corporates (by approximately half).

The above amendment to Clause 7 would then allow for the following amendments the R&D Premium, which applies as an additional benefit on top of the base rate, based on R&D intensity:

- **Clause 9 – Sub-section 355-100(1A):**

	R&D intensity rate	R&D Premium benefit rate
Item 1	exceeds 2% but does not exceed 5%	2.5%
Item 2	exceeds 5%	5%

We recommend that the top intensity threshold rate be no higher than 5% in order to access the top R&D benefit of 12.5%. We recommend that the intensity rate of 10% be deleted entirely, as it is excessively high for the Australian economy, and as such is not achievable for all but the most high-tech dedicated R&D companies. The R&D Premium should ensure that it is setting a realistic or attainable goal for the majority of businesses to strive towards.

We also recommend that, given the small additional percentage being offered under the R&D Premium, the proposed rates be applied on *volume basis*, not an incremental basis. If a company’s R&D intensity exceeds the thresholds, then these higher rates should be available on the whole R&D expenditure amount, i.e. the R&D benefit that could be claimed if the Premium rates applied would be either 9c/\$ or 11.5c/\$, offering a slightly lower top level rate for the overall program budget.

Alternatively, if the incremental basis is retained, then we recommend that the rates of the additional benefit be considerably higher so that they are an effective incentive, e.g. the above amended rates should increase to around 5% and 10% of the incremental amount respectively. The R&D intensity thresholds at 2% and 5% are very ambitious so these R&D Premium rates need to provide a greater benefit to induce that additional expenditure to occur.

We recommend that these options be modelled and considered as alternative designs for the mechanism.

- **Clause 12 – Section 355-115:**

“R&D entity’s expenditure” – to create more certainty for business and the ATO as regulator the denominator (total expenditure) should be referenced to a number that is known at a much earlier point in time. For example, this could be the prior year, or to the past 3-years rolling average, as it would enable better line of sight for planning purposes at the beginning of the year. It would not however do anything to overcome the problems of complexity, and integrity/verifiability for the regulator. A lot more work needs to be done to streamline and clarify what is included in the “R&D entity’s expenditure” definition if it is to overcome the

potentially duplicated expenditures, ambiguities around accounting principles, and unintended interactions with the myriad of other tax laws.

3. Responses to the Consultation questions

Based on the above comments, we now provide a response to the Consultation questions in relation to the R&D intensity mechanism:

1. ***Do you foresee any implementation and compliance challenges arising from the calculation of R&D intensity?***

Yes, for all the reasons outlined above. These include complexity, uncertainty, inequity, and inefficiencies for both business and regulators, and the tax system itself. This means excessive compliance/assurance costs for inadequate reward, which are likely to be of such a magnitude that they will compromise participation in the program, and therefore the ‘additionality’ currently being achieved by the existing incentive, the success of which has been confirmed in the academic literature.

In a February 2016, Swinburne University study specifically on ‘[The Additionality of R&D Tax Policy in Australia](#)’,⁹ the Australian R&D Tax Incentive policy was found to deliver additionality in the range of \$0.80c - \$1.90c, which “compares favourably with estimates from other countries”. (at p.3)

Firms participating in the R&D program were found to invest around 40% more R&D than similar firms not registered to receive the R&D incentive. This translates to additionality of approximately \$0.8 - \$1.7 for every dollar of tax revenue foregone. Should a majority of firms decide to drop out of the R&D program, this substantial additionality will be lost as we expect that their Business R&D Expenditure (BERD) will drop off.

Swinburne also found that the introduction of the current R&D Tax Incentive lead to a 14% increase in R&D spending by the sample firms claiming in both 2011 and 2012, compared with the former R&D tax concession. This translates to additionality of \$1.9 dollars of tax revenue foregone. (at p.6)

On this basis, the R&D Tax Incentive, specifically retargeted in 2011, is achieving substantial reliable additionality and the Government should take extreme care not to damage the success and standing of Australia’s R&D Tax Incentive. Investment-grade certainty is required if we are to ensure continued long-term R&D investment by private firms in Australia.

In addition, Swinburne notes that the study does not take into account potential additional tax revenue from firms that have higher future taxable income due to the increased R&D investment as a result of the incentive, so this would be an additional positive outcome to factor in. (at p.9)

Finally, Swinburne’s report notes that:

[I]t is vitally important to bear in mind that inducing additional R&D is not an end in itself. The rationale for subsidising R&D is to induce positive spillover benefits to other firms and consumers. (at p.9)

In this regard, Swinburne states that the value of these spillover benefits (in terms of material well-being) to other firms and individuals is considerably greater than one dollar for each dollar of R&D investment, and this is backed by extensive empirical evidence and theory. Swinburne also notes that these “welfare-enhancing spillover benefits” would otherwise be foregone. (at p.9) As

⁹ Jared Holt, Ahmed Skali and Russell Thomson (2016), [The Additionality of R&D Tax Policy in Australia](#), Swinburne University of Technology, Centre for Transformative Innovation, *Working Paper 3/16*.

such, they provide a broader argument in support of the efficacy of government allocation of R&D spending to private firms.

The additionality and spillover benefits generated by the R&D Tax Incentive have also been affirmed by the findings of the Centre for International Economics (CIE). As reported in the Review Panel's Issues Paper, CIE found additionality of up to \$1 additional R&D expenditure for every \$1 tax foregone for large companies, and for SMEs up to \$1.50 additional R&D expenditure for every tax dollar foregone.

CA ANZ is therefore very surprised by and disagrees with the Review Panel's statement that the current R&D program "falls short of meeting its stated objectives of additionality and spillovers."

Based on the above findings, CA ANZ considers that the R&D Tax Incentive is providing very good value to the Government in terms of leveraging 'additional' private R&D spending that would not otherwise occur for the benefit of the Australian economy by financing innovation, and in generating broader material spillover benefits enjoyed by other firms and individuals in Australia.

The Government must make a careful and prudent policy and tax law design decisions here in relation to the proposed R&D intensity mechanism to ensure that the additionality currently being induced from private firms is not compromised, but rather can be maintained or improved.

2. Does the proposed method of calculation of R&D intensity pose any integrity risk?

Yes, as discussed above, one of the greatest integrity risks we see is the complexity that is introduced by the R&D intensity rules. We question why the Government would choose to introduce such an inefficient model for a subsidy that is meant to be a clear, attractive incentive for honest business, and a deterrent for dishonest business to claim? It seems to achieve the opposite. Such complexity will create a new integrity risk for the R&D program as potentially inaccurate claims will be very difficult for the ATO to have the bandwidth to audit, detect and successfully enforce in Court. There are so many moving parts to the formula, including questions of fact and complex questions of law. Accordingly, we anticipate that the regulatory cost of resourcing the administration and enforcement of the R&D intensity calculations that apply to every single claimant of the non-refundable offset will be prohibitory. We believe that the R&D intensity measure will be unworkable and unadministrable in practice. The R&D Premium's complexity is in our view not fit for purpose in a modern R&D program, particularly within a tax system aiming for digital transformation.

3. Could expenditure be aggregated across a broader economic group? Would this create any implementation and ongoing compliance challenges?

On balance, no we would not recommend aggregating expenditure across a broader economic group. This is because firstly all of the compliance complexities discussed above would be exacerbated. Secondly, it would not be appropriate to have R&D expenditure at the entity level as the numerator, and total R&D expenditure at the group level as the denominator.

If however total expenditure is calculated at the entity level, then we can also envisage that there will be those who seek to game the system by altering their existing structures and arrangements so as to manipulate the formula, and artificially place themselves into a higher R&D benefit bracket. We are aware that this sort of practice occurred under the former 175% Incremental Premium, where there were unintended consequences and windfalls produced by group restructures, as well as those that arose as a result of anomalies and inadvertent outcomes. We would therefore remind Treasury and the Government that we should learn from and avoid repeating mistakes of the past.

Rather than attacking these scenarios by a group-wide approach to expenditure, we believe that the proposed amended anti-avoidance rules relating to schemes would be the best way to deal with these potential problems.

We note however that we would expect the ATO to issue guidance on the intended operation of the amended anti-avoidance rules to make it clear that existing accepted, common place structures and arrangements between trusts and their associated corporate R&D entities can continue to be legitimately used by those business groups to avail of the R&D Tax Incentive.

Conclusion

Chartered Accountants ANZ considers that the proposed R&D Premium and intensity mechanism, if implemented as drafted, would likely have a profound and adverse impact on participation in the R&D Tax Incentive program, which would lead to a drop in BERD, rather than encouraging additional private R&D expenditure. Decreasing Australia's BERD at a time when the Government's objective is to increase Australia's additional private investment in R&D could create a significant risk for the Government's Innovation agenda and could impact our nation's immediate ability to innovate and compete in trade, technology development and talent attraction in a global market.

We believe that there are much better policy levers that could be developed to increase additionality, such as by targeting other indicators of high value R&D to the Australian economy. We would be pleased to work with Treasury and the Government on this.

If R&D intensity as a policy target is proceeded with, we urge Treasury to firstly, ensure that the tax law design of the R&D Premium rules ultimately adopted are sufficiently simple to be capable of nuanced and calibrated modelling so as to obtain a level of comfort around the likely real world impacts of the new rules.

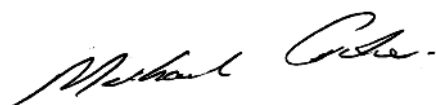
Secondly, we urge Treasury to ensure that, prior to adopting an R&D intensity mechanism as the policy target, an analysis of the Australian economy is done to confirm whether the Australian economy has a structural composition that is capable of responding to an R&D intensity stimulus. This will be vital so as to ensure that if BERD drops off in traditional industry sectors, new BERD is capable of significantly increasing in industry sectors within the Australian economy that can respond to R&D intensity stimulus. Based on the literature we have identified and cited in this submission, we have considerable reservations that Australia is an appropriate economy for R&D intensity as a policy target.

Should the Government nevertheless decide to proceed with the R&D Premium intensity mechanism, we recommend that the amendments proposed in 2.5 be considered and adopted, as we submit that this would be the best way to implement the R&D intensity policy decision.

We trust that the comments in this submission are of assistance to Treasury, the ATO and the Government. We would welcome the opportunity to meet or dial in, and discuss our submission with you in further detail should this assist.

In the meantime, if you have any questions about any aspect of our submission, please contact either Ms Donna Bagnall on (02) 9290 5761 or donna.bagnall@charteredaccountantsanz.com, or myself on (02) 9290 5609 or michael.croker@charteredaccountantsanz.com

Yours sincerely



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