



11 July 2018

Manager
Small Business Entities & Industry Concessions Unit
The Treasury
Langton Crescent
PARKES ACT 2600

By email to: RnDamendments@treasury.gov.au

Dear Sir/Madam,

Thank you for the opportunity to respond to the proposed amendments to the R&D Tax Incentive program 2018.

CEBO is a registered tax agent that specialises in providing advice and assistance to over 150 clients in relation to the R&D Tax Incentive program. Our client base includes many in the SME segment of the market and companies operating in most industry sectors throughout Australia.

We do understand the need for controlling the impact that this program has on the Federal Budget and our responses should be viewed in this light.

Calculation of R&D Intensity under the R&D premium \geq \$20 million Turnover

This change appears to be based on a belief that this will increase the incentive for larger companies to invest a higher percentage of their total expenditure on R&D.

It is our contention that:

- Such a belief may be true for smaller entrepreneurial enterprises where the program often underwrites the additional employment of an R&D specialist
- The focus and investment of R&D in larger companies is determined almost totally by the needs of the company – in marketing terms - and that having a rising scale of reward, as proposed, will not change this focus or investment. For example, many companies would fall into the category that would receive a net benefit in the range of 4% to 6.5% and may determine that this does not warrant the effort and cost of making a claim.

Thus, we question the entire basis for the changes in this regard.

As to the calculation of R&D intensity, we foreshadow significant problems and unforeseen effects:



- Companies with high trading volumes and low margins, particularly in manufacturing, will be penalized by the changes as their total expenditure is a very high percentage of their revenue. Companies with low input costs and high profit margins, such as the gambling industry, could be advantaged.
- We have a number of clients, of this size, that fall into the manufacturing sector and, in some cases, the existing program is a borderline proposition in terms of net benefit – the benefit after the costs of inclusion. It is likely that the program will have no interest for a number of these.
- While there is a correlation between the intensity of R&D activity and turnover growth¹, there appears to be no evidence that increasing the relative benefit of the program to high intensity enterprises will have a positive effect of encouraging additional R&D activity. The premise of the program is that by offering higher benefits for greater intensity of R&D expenditure this will provide an incentive for companies with lower intensity to increase their R&D spend, in order to gain a higher benefit. There is no evidence to support this contention.

In essence, we perceive this as a very blunt instrument without evidentiary support.

Companies with ≤ \$20 million Turnover

We have been struck by the lack of comment in the media relating to the proposed reduction of the net benefit of the program for small business from 15% to 13.5% - **a reduction of 10% in net benefit**. While innovation in this sector is significantly supported by the program, the proposed change appears at variance with the Government's focus on increasing innovation and supporting jobs growth in smaller, often family based, manufacturing businesses. This is a sector that has been decimated over the past 20-30 years and what little government support is left is gradually being whittled away.

Other Issues

\$20 million Threshold

We have some doubts about use of a \$20 million aggregated turnover threshold as this penalizes businesses with high input costs such as manufacturing.

The manufacturing sector is penalized by the reduction in benefit of the program once \$20 million in turnover has been reached. Service industry and companies that operate in conditions of oligopoly, where higher margins are prevalent, can generate similar returns with less than half the revenue and, yet, are given a much higher net benefit by the program.

¹ Australian Innovation System Report 2017, Department of Industry, Innovation and Science, p 69



Perhaps aggregated turnover is not the best measure for determining benefit in the program.

Australian Government's Investment in Innovation

The Chief Economist's Australian Innovation System Report 2017 clearly identifies a strong correlation between the level of R&D Activity and growth in turnover, labour productivity and wages². And, yet, the Government is reducing its investment in the support of R&D and innovation.

ICT Sector

We note that the rapid expansion of the proportion of the benefits of the program has come from the ICT sector.

The dramatic change in interpretation of the Act relating to the ICT industry is understandable in light of the scale of this sector, in terms of the percentage of the total cost of the program that this consumes, and the rate of growth of the value of applications. However, it is our perception that the issue would have been better addressed by excluding ICT from the R&D Tax Incentive program and mounting a separate incentive program for this industry. This would have allowed much better targeting of benefit. Grant programs could also have been used to refine the desired result and the Government could easily gauge the impact of such a program on persuading companies to retain ICT development in Australia as opposed to moving this activity to cheaper suppliers in Asia.

Yours faithfully

A handwritten signature in blue ink, appearing to be 'RM', with a large, stylized initial 'R'.

A handwritten signature in blue ink, appearing to be 'TE', with a long horizontal line extending to the left.

Rodger Morton and Tim Edgecombe