



# TREASURY LAWS AMENDMENT (RESEARCH AND DEVELOPMENT INCENTIVE) BILL 2018

Response to the Consultation

July 2018

## ABOUT RESEARCH AUSTRALIA

**Our vision:** Research Australia envisions a world where Australia unlocks the full potential of its world-leading health and medical research sector to deliver the best possible healthcare and global leadership in health innovation.

**Our mission:** To use our unique convening power to position health and medical research as a significant driver of a healthy population and contributor to a healthy economy.

**Our role:**

**Engage**

Australia in a conversation about the health benefits and economic value of its investment in health and medical research.

**Connect**

researchers, funders and consumers to increase investment in health and medical research from all sources.

**Influence**

government policies that support effective health and medical research and its routine translation into evidence-based practices and better health outcomes.

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## Summary of recommendations

<p><b>Definition of Clinical Trial</b></p>	<p>Research Australia proposes Treasury consider a definition that better embraces the range of interventions that can be the subject of a clinical trial. For the purpose of comparison, we refer to the World Health Organisation definition.</p>
<p><b>Reduction in expenditure on the R&amp;D Tax Incentive</b></p>	<p>There should not be any changes to the rate of the R&amp;D Tax Incentive at this point in time. Any such changes should only be made after an appropriate evaluation of the economic impact of the R&amp;D Tax Incentive has been able to be made and this may not be possible for several years.</p> <p>The Bill will reduce the level of Government support for the R&amp;D undertaken by research intensive companies, regardless of reductions in the corporate tax rate. This has a direct impact on the capacity of these companies to undertake research and development, including their ability to employ the staff they need. And it is occurring against the backdrop of a recent fall in private sector investment in R&amp;D when the Government's ambition for future Australian prosperity relies on an 'Innovation Nation'.</p>
<p><b>Commencement of the reduction in R&amp;D Tax Incentive rates</b></p>	<p>Applying the reduction in the R&amp;DTI rates with effect from the start of this current financial year, introduces even greater uncertainty and affects current expenditure plans on R&amp;D. This is particularly for small companies rely on the refundable offset. Research Australia submits that if the R&amp;DTI rates are to be reduced, it should be with effect from the next financial year.</p>

# TREASURY LAWS AMENDMENT (RESEARCH AND DEVELOPMENT INCENTIVE) BILL 2018

## RESPONSE TO THE CONSULTATION

### Introduction

Research Australia welcomes the opportunity to make this submission, which is informed by the Issues paper and the consultation meeting attended in Melbourne on 17 July.

Research Australia is supportive of the R&D Tax Incentive, and while we have concerns about the reduction in support that will result from this Bill, we are very pleased to support the exemption from the cap for clinical trials.

Successive Australian governments have identified the economic and other benefits that derive from encouraging the conduct of both commercial and non-commercial clinical trials in Australia and has provided a range of different policies and programs in support.

This in turn, has helped to increase the number and value for clinical trials conducted in Australia, generating export income and supporting local drug and medical device development. As a vital but expensive R&D activity, the clinical trial exemption from the cap is essential to ensuring that this concerted, cross portfolio effort has not been in vain. For this reason, the focus of Research Australia's submission is the clinical trial exemption and the definition of clinical trial.

While we are aware that the decision to reduce the value of the refundable and non-refundable R&D tax Incentive is government policy and not formally part of the consultation, we also comment on the impact of these measures on the health and medical research and innovation sectors. The environment has changed since they were first countenanced several years ago and the reduction in the level of support warrants reconsideration.

## Clinical Trial exemption under the \$4million cap

Research Australia notes that Treasury is proposing to adopt the definition of a clinical trial used by the Therapeutic Goods Administration. While acknowledging the benefit of using a single, common definition, concerns have been raised within the health and medical research and innovation sector that this definition does not adequately cover medical devices and newer interventions being developed with scientific advances.

Research Australia proposes Treasury consider a definition that better embraces the range of interventions that can be the subject of a clinical trial. For the purpose of comparison, we refer to the World Health Organisation definition. This definition includes a more comprehensive list of the types of interventions that can be the subject of a clinical trial

*'any research study that prospectively assigns human participants or groups of humans to one or more health-related interventions to evaluate the effects on health outcomes. Clinical trials may also be referred to as interventional trials. Interventions include but are not restricted to drugs, cells and other biological products, surgical procedures, radiologic procedures, devices, behavioural treatments, process-of-care changes, preventive care, etc.'*<sup>1</sup>

This list is indicative of the rapid advances being made in health and medical research and the range of different types of interventions that are being developed. What they all have in common is the need to be tested in a clinical trial to establish their safety and efficacy.

Research Australia is keen to ensure that any definition of clinical trial legislated in respect of the R&D Tax Incentive, does not unintentionally exclude one or more types of intervention that exist now or might evolve in the future.

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<sup>1</sup> <http://www.who.int/ictrp/en/>

# Reduction in expenditure on the R&D Tax Incentive

A stated objective of the current Bill is to reduce the total level of government expenditure through the R&D Tax Incentive. Such a reduction was first announced in the 2014-15 Budget with tax offsets available under the research and development tax incentive for the first \$100 million of eligible expenditure to be reduced by 1.5 percentage points.

This measure was followed by the 2016 review of the R&D Tax Incentive, which is the genesis for the proposals contained in the current Bill. The initial Budget announcement and the Review occurred against the backdrop of expenditure on the R&D tax Incentive which was increasing at a rate that exceeded successive budget forecasts.

More recently however, we have seen a reduction in private sector R&D activity. This reduction is largely unexplained and unexpected. Research Australia is concerned that the proposed reductions in the R&D Tax Incentive are being undertaken without assessing the impact it has had on R&D activity in Australia since its inception in 2011. Nor has there been an assessment of the impact of the subsequent reductions in the R&D tax Incentive rate.

The real measure of effectiveness of the R&D Tax Incentive is the degree to which it has caused additional R&D in Australia that results in additional economic benefits. This will always be difficult to determine as there are many factors that affect the level of R&D undertaken in any country at any time, of which the R&D Tax Incentive is only one. In addition, the R&D Tax Incentive has only been operating since 2011 and R&D is typically a long and time consuming process. It can take many years for products to make it to market and generate revenue; consequently, the R&D Tax Incentive has probably not yet been operating for a sufficient period to determine its economic impact.

**Research Australia submits that there should not be any changes to the rate of the R&D Tax Incentive at this point in time. Any such changes should only be made after an appropriate evaluation of the economic impact of the R&D Tax Incentive has been able to be made and this may not be possible for several years.**

While Innovation and Science Australia's Report supported a reduction in expenditure on the R&D Tax Incentive in the context of increased government expenditure on other measures to support innovation and a commitment to a funding 'floor' of its medium-term average of 0.63 per cent of gross domestic product (a modest proposal), no such commitment has been made by Government.<sup>2</sup>

Part of the argument advanced for the reduction in the refundable R&D Tax Incentive is that small companies will benefit from the reduction in the company tax rates that have been implemented in recent years. On face value it appears that the reduction in the rate of the R&D tax incentive would be revenue neutral for the companies involved i.e. the benefit of the R&D tax incentive will be reduced but this loss will be made up by a corresponding reduction in income tax paid.

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<sup>2</sup> Innovation and Science Australia 2017, *Australia 2030: prosperity through innovation*, Australian Government, Canberra. Recommendation 6

However, this reasoning is fundamentally flawed; it assumes that the companies receiving the refundable R&D tax incentive are paying sufficient income tax to receive the benefit of the reduction in the tax rate. This is clearly not the case; many of these companies are paying little or no income tax because they are operating at a loss for many years while they are in the process of developing products for market.

This fact is recognised in the design of the R&D Tax incentive, and is the reason why the refundable component is refundable i.e. it is **expected** that the value of the R&D tax incentive will exceed the value of the tax payable. In this situation, the reduction in the rate of the R&D tax incentive is not 'revenue neutral', and results in a direct reduction in the support provided to small innovative companies in their early stages when they need it most.

The consequence of the Bill will be to reduce the level of Government support for the R&D undertaken by thousands of small research intensive companies, regardless of reductions in the corporate tax rate. This has a direct impact on the capacity of these companies to undertake research and development, including their ability to employ the staff they need. And it is occurring against the backdrop of a recent fall in private sector investment in R&D when the Government's ambition for future Australian prosperity relies on an 'Innovation Nation'.

## Commencement of the measures

Applying the reduction in the R&DTI rates with effect from the commencement of this current financial year introduces even greater uncertainty and affects current expenditure plans on R&D, particularly for small companies rely on the refundable offset.

**Research Australia submits that if the R&DTI rates are to be reduced, it should be with effect from the next financial year.**



## Conclusion

Research Australia welcomes the proposal to exempt clinical trials from the \$4million cap, and our submission seeks to ensure that this exemption is implemented effectively.

Private sector R&D is critical to Australia's future prosperity as a nation. The R&D Tax Incentive is still a relatively new scheme introduced to better target and streamline Australian Government support for private sector R&D. It has already been subjected to several changes, the effects of which have not been evaluated

The proposed reduction in the R&D Tax Incentive occurs at a time when Australia needs to boost rather than wind back its support for R&D.

*'Looking towards 2030, innovation will be integral to the expansion of Australia's economy, keeping its workforce strong, and addressing societal challenges. Australia will need to be competitive in a global innovation race by scaling up more high-growth industries and companies; commercialising more high-value products and services; fostering great talent; and daring to tackle global challenges.*

*Yet just at the time when Australia needs to accelerate its innovation performance, we are falling behind our global peers, particularly in student performance in science and mathematics, and in business investment in research and development. This is more than a canary chirp in our economic mineshaft: it is a clarion call for national action.'*<sup>3</sup>

Research Australia supports these views expressed by Bill Ferris AC, Chair of Innovation and Science Australia. Research Australia is of the view that the proposal to reduce the R&D Tax Incentives in the current climate is ill-advised and lacks longer term risk-benefit weighting. It is at odds with the need to accelerate Australia's innovation performance.

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<sup>3</sup> Innovation and Science Australia 2017, *Australia 2030: prosperity through innovation*, Australian Government, Canberra. p.iii

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