Canberra Region
Advanced Technology
Manufacturing Association

C/- CEA Technologies P/L
PO Box 1095
FYSHWICK ACT 2609
Phone: (02) 6213 0000
Fax: (02) 6213 0013

14 April 1999

The Secretary
Review of Business Taxation
Department of the Treasury
Parkes Place
CANBERRA ACT 2600

Dear Sir

Please find attached our submission on the second discussion paper, 'A Platform for Consultation', together with an electronic copy.

As background information I advise that the Canberra Region Advanced Technology Manufacturing Association (CRATMA) started off as a CEO breakfast club for advanced manufacturing companies but found that it needed to form an association in order to assist both Government and industry in the formulation of policies affecting the advanced technology sector. CRATMA has as its members the Managing Directors of about twenty-five high technology companies in the Canberra region. The majority of these companies are SMEs and the combined annual turnover was in excess of $447M last year. They employ over 1,500 people and a high percentage of the turnover is in exports.

All the companies are manufacturers of hardware products. The products range from radar systems through to fibre optic components; security systems to satellite hardware. This association is very important to Canberra as it is expanding and diversifying the employment base from the public service and the service industry. A member list is attached for your information.

Copies of the submission are available for interested parties from my Personal Assistant, Margaret Kennedy who can be contacted on tel 6213 0201.

Yours faithfully

David J. Gaul
Chairman

REVIEW OF BUSINESS TAXATION

SUBMISSION

CAPITAL GAINS TAX AND R&D TAX CONCESSION

Executive Summary:

This submission deals with the implications on the advanced technology industry sector of variation of CGT and the 125% R&D Tax Concession. It is submitted that:

1. There is an interrelationship in the innovation process between CGT, R&D Tax Concession and direct Government funding. This interrelationship predicates that both Government R&D Funding and the Tax Concession be maintained, and that the CGT be reduced;

2. As well as a general reduction in CGT there should be a further targeted reduction applying to innovative industry (being higher capital risk, with high potential growth and high earnings potential) so that investment in this industry accrues a maximum CGT of 20%. It is further submitted that ISR should be the responsible government department for establishment of a Register of Innovative Ventures;

3. A stepped rate CGT is equitable to reward long term investment;

4. All tax payers must be able to gain the benefit from investment of risk capital in registered innovative ventures;

5. Any variation of CGT must take into account that a significant proportion of Australian innovative industry is publicly listed, and that investment in this industry is the major means by which Australians can invest in national economic growth.

6. Australian Superannuation Funds represent a paradox in the investment and taxation arenas and should be provided with specific additional relief for investment in Australian innovative ventures;

7. Roll over relief should apply for scrip-for-scrip transactions;

8. An increase in the R&D Taxation Concession is essential if Australia is to build a competitive advanced technology industry base;

9. A decrease of the R&D Tax Concession would result in a reduction of industrial R&D.

Submission:

In this submission reference is made to Review of Business Taxation, A Platform for Consultation, Discussion Paper 2 – 'Building on a strong foundation'. This is referred to simply by the Chapter reference numbers (e.g. 11.1).

In this submission we do not attempt to calculate the quantum extent to which the proposals meet the overall criterion for revenue neutrality as it is reasoned that the adoption of the measures will result in nett additional revenue. This arises from the premise that the measures will create growth in the form of job creation and business profitability at a level substantially in excess of that forecast without these measures. Consequently, the measures will result in nett additional revenue early in the implementation period, due to the impact of increases in PAYE, business taxation, and GST from the increased business activity.

1. Innovation – The interrelationship between CGT, R&D Tax Concession and Government R&D Funding

1.1 Innovation is, by nature, a lengthy process involving many stages. The attached diagram shows these stages. The early stages of the innovation process involve high risk R&D that is carried out usually in association with Universities and Government Laboratories (though it may also involve companies specialising in R&D). To provide the catalysis for this creative phase, it is essential that the Government be in partnership with the R&D community.

1.2 The middle stage of the innovation process involves establishment of a spin-off company, or investment by an existing company in the technology. This high-risk investment period requires capital for both product development and market awareness, for which targeted CGT is sought (see Para 2 below). In addition funds are required for resolution of remaining areas of technical risk and solving of problems identified in product development and pilot production. It is therefore important in this middle stage of the innovation process that Government continues as a partner and that the R&D Tax Concession is restored to 150 per cent.

1.3 The third stage of the innovation process is early stage production and commercialisation – being the period from initialisation of production until positive cash flow is generated. This is the phase where it is essential to maintain the R&D investment for development of next generation product and for product modifications necessary to meet market expectations for performance, reliability or price. In this phase, risk capital is the essential element, for which a low CGT is necessary. In addition, the R&D Tax Concession is an essential element to enable the company to return earnings to the business to stimulate growth. The is the final stage of the innovation process and, it is submitted, the completion of the R&D process for which R&D Tax Concessions and CGT relief should apply.

1.4 Many organisations involved in R&D are not in a position to take full advantage of growth through R&D Tax Concessions due to being in tax loss and through not having sufficient tax losses to be able to utilise any of the approved structured finance packages. Companies can currently seek support from ISR, to augment whatever equity capital is available. Nevertheless, tax loss entities are still unable to obtain commercial debt and therefore are restricted to a mix of equity and support from government programmes. Consequently, the current measures must be maintained, and, if possible, be increased and be more targeted.

2. Targeted CGT involving ISR

2.1 The suggested reduction of the CGT to 30% will not be sufficient to result in a significant increase in risk capital (ref 11.15). However, some capital will go to the lowest risk investment providing the highest early return. Historically in the Australian public markets(s), the highest returns have been provided by the publicly listed financial institutions and service providers. It is reasoned that, following a decrease in CGT, there will be an initial sell-off of investments and stocks that have appreciated substantially, by investors who have been locked in by the high CGT. However, the availability of high franked dividends from those public companies will most probably result in an influx of capital to those corporations creating new capital gains. Simply, the mobilised capital will drift primarily to the low risk service industries at the expense of new industry.

2.2 Therefore, it is essential to differentiate between CGT on low risk investments and CGT on high risk investment. Low risk ventures are traditionally considered to be real estate, shares in service providers, and investments with a guaranteed return. It is obvious that returns from disposal of these investments should not receive additional targeted tax relief. There are also a range of other relatively low risk investments that can accrue capital gains. These investments include but are not limited to fast food franchise outlets, other `Top 500' Stocks on the ASX, shares in established businesses with low growth and high short term profitability, established mining and refining ventures, forestry, and agency businesses. Because of the difficulty of defining clearly in commercial terms which ventures are low risk, it is contended that only investment in innovative ventures be granted targeted tax relief , as these ventures also offer highest potential growth and earnings.

2.3 In order to obtain investment for innovative (high capital risk, high potential growth, high potential earnings) industry, investment should be targeted to achieve a lower CGT (11.68). It is essential that the innovative ventures not be limited to those which are targeted by a particular investment sector. For example, the Venture Capital industry targets small private companies with existing products, particularly in IT, which ventures can be transformed into businesses for ultimate public listing through an IPO. The Venture Capital industry does not invest in companies already listed on the ASX, only invests a small proportion of funds in early stage technology ventures and invests virtually nothing in start-ups. (Anecdotal evidence suggests that this is still the case with the IIF's). Consequently, the majority of potentially high growth technology industry is not served by Australian style Venture Capitalists. Therefore, there is an argument that the Australian Venture Capital (AVC) organisations should not, in itself, qualify for additional tax relief. The AVC should only get such relief when it invests in eligible businesses,(see Para 2.5 below). **This submission contends that all innovative industry be targeted for particular CGT relief. It is proposed that investment in this industry accrue a maximum flat rate CGT of 20%.**

2.4 The risk of capital loss would be partly overcome by the provision of CGT relief. Nevertheless, a significant proportion of investor groups (e.g. superannuation funds) are unwilling to invest where there is perceived high capital risk unless that perceived risk provides for offset of gains by losses. It is recommended that only losses arising from investment in businesses, for which CGT relief is obtained, be allowable for offsets against gains. The extent to which such losses may be carried forward should be related to the period for which the investment has been held and, in any case, be limited to 10 years.

2.5 **It is recommended that ISR be tasked with development of a Register of Innovative Ventures for which investment could obtain CGT relief (11.73).** This register would be formed by application from `innovative' organisations, with assessment similar to that used for Registered Research Agency registration (11.72). This register should provide for both single and multi-venture organisations. Through this mechanism, a company will be encouraged to establish several synergistic multi-disciplinary ventures based on like core technology – thus providing a multiplier effect in commercial returns. The Register of Innovative Ventures would provide a low compliance cost for investors (11.74) who could also access the register from the web. The web site could be updated on a six monthly basis to provide for rollover of ventures from high capital risk to development capital. The period could be adjusted to minimise risk to revenue. Nevertheless, if the compliance responsibility and tax liability vested in the applicant organisation, the revenue risk would be minimised (11.74). The register will also provide a means for smaller innovative companies to be credibly profiled for investors and therefore encourage Australian investors to take early positions with these companies.

3 Stepped Rate CGT

3.1 Innovation is a process that has different dynamics for different industries. It is not unusual in the energy, materials science, and biotechnology industries for a project to have a gestation period of over ten years. During this period patient capital is required. Obviously, the risk is higher with longer periods of investment, both from the point of view of market competition and cost of development.

3.2 A stepped rate CGT, similar to that in force in USA (Table 11.1) or UK (Table 11.2), is an appropriate and fair model. Any CGT relief granted must be provided for investment in all registered organisations (Para 2.6 above).

3.3 A flat stepped rate is proposed for investment in a Registered Innovative Venture with a compliance period of 7 years (to match other financial recording requirements). It is recommended that, to reduce compliance and administration costs, there be three periods. **For investments of up to two years, no benefit should accrue beyond that obtained for investment in a registered innovative venture (i.e. 20% CGT). For investments of three to four complete years, further relief of 5% should be granted. For investments of over 5 complete years, the CGT should be 10%. The provision of Para 11.40 concerning quarantining of capital losses should apply.**

4. Any Benefit granted for CGT and other tax relief to be available to all Tax Payers

4.1 To achieve equity, no corporate or ordinary private taxpayer should be favoured or disadvantaged with regard to having the opportunity to invest in innovative ventures that are granted CGT relief.

4.2 The proposal to grant each taxpayer $1,000 relief from CGT will have an immediate negative effect on revenue, but may not stimulate a large move of investment that would not have already occurred. In addition, the message from the recent NSW election is that the general public is not enamoured by `cash back' offers. It is more important to educate taxpayers in the strategies and tactics for capital investments leading to enhanced savings and investment in capital growth entities.

4.3 It would be inequitable for investors in venture capital funds or any management or broker/merchant banking organisation to be granted an advantage over other taxpayers. If benefits were granted to only a limited number of taxpayers, the benefit could be subject to abuse.

4.4 The opportunity for investors should be provided by the entity approved as a Registered Innovative Venture. This entity, which may be public or private, must have the ability attract its portfolio of equity capital investors from the widest possible market place. All ordinary taxpayers must have an opportunity to invest in targeted ventures whether it be through private funds, direct private investment or through the ASX. This also means tax concessional investments should be available directly for individual investors not just through company structures.

5. Significant proportion of technology business Publicly Listed

5.1 For a variety of reasons, since the mid 1980’s until recently, a significant number of technology enterprises have elected to list on the ASX. Some of the reasons include lack of early stage venture capital, flow on from second board, and quantum of funds required.

5.2 These companies are already established and have strong management teams, but have been severely disadvantaged in raising funds by the current CGT regime and attitudes of the venture capital industry.

5.3 **Public listed companies provide the main means by which the average Australian taxpayer may invest in capital growth business. Public listed technology companies represent an existing equity base of $2,303 Million (Shares Magazine 2/099), much larger than the equity base of the Australian venture capital funds. It is essential that these public listed companies be provided with equal advantage to access mobile capital released by reduction of CGT.**

6. An inequitable paradox – Benefit for Australian Superannuation Funds

6.1 Australian superannuation funds are a form of compulsory savings. As such, these organisations are provided with significant taxation relief. They therefore represent a paradox in the investment and taxation arenas. The taxation rate of 15% applies to any investment in Australia or overseas.

6.2 Australian superannuation funds do not invest sufficiently in Australian growth industries. The APRA Report for 31 December 1998 shows that 'superannuation funds have taken advantage of more favourable equity and overseas markets'. In addition superannuation funds have increased investment overseas to $61.6 Billion, a rise of $4.8 Billion.

6.3 Arguments have been put forward that Australia should provide US Pension Funds with a 'tax holiday' for investment in Australian ventures. This argument has the following weaknesses:

a) US Pension Funds are already granted zero tax liabilities in a number of other international jurisdictions, so Australia, would not be particularly advantaged;

b) US Pension funds return the profits to USA investors, so the only advantage to Australia is job growth;

c) The exit strategy for US Pension Funds is more likely to be a sale to a US corporation or listing on NASDAQ, so there would be marginal advantage to Australia from the growth of the venture;

d) Such a tax holiday would prejudice against Australian and other international investment funds.

6.4 It is proposed that Australian superannuation funds be granted a flat rate of 10% for investment in registered innovative ventures for periods up to 2 years, 7.5% for three to four years, and 5% for periods longer than 5 years. The same provision for capital losses should apply as to other taxpayers (see Para 2.4 above).

7. Roll-over relief for Scrip Transactions

7.1 To the same extent that all ordinary tax payers should have the same rights and responsibilities associated with CGT, all ordinary tax payers should be treated equally in scrip for scrip roll-over relief.

7.2 Rollover may occur through merger/acquisition, or deconsolidation. Such a transaction may be private to private, private to public, public to private, or public to public.

7.3 Scrip for Scrip Relief should be provided to all such transactions.

7.4 This submission does not contend that takeovers are necessarily positive from the viewpoint of growth or tax revenue, but, simply, that no taxpayer should be disadvantaged by a scrip issue rather than by cash.

7.5 The effect on revenue can be reduced by providing for a phased payment of CGT, due from the transaction, over a five year period.

8. Increase in R&D Tax Concession is Essential

8.1 The report eloquently makes the point concerning the economic importance of the advanced technology and innovation sectors to Australia's future growth potential. This submission fully endorses that point.

8.2 The introduction of the 150% R&D Tax Concession resulted in a large real increase of R&D effort in industry, and expansion of the corporate relationship with universities and research organisations. The benefit from this insurgence of activity has not been realised in Australia to the extent that was anticipated due to the reduction of the benefit to 125%, market place expectation of franked dividends, the high CGT, and changing definition of R&D.

8.3 Since reduction of the concession to 125%, there has been a steady decline of R&D effort in Australia to a point where we our national effort compares unfavorably with other OECD countries. Additionally, transnationals are moving R&D to more favourable jurisdictions in S.E. Asia where the benefits are typically 200%.

8.4 Australian R&D is about half the cost of R&D in other first world countries plus we have a productive R&D culture with a skilled workforce, leading to highly cost effective innovation. Consequently, Australia can gain a multiplier benefit from R&D.

8.5 There needs to be a sufficient incentive for companies to commence R&D and carry it through to commercial fruition. Since the R&D tax concessions were first introduced in 1985, the value of the tax concession has fallen by 60% to 9 cents in the dollar. The proposed lowering of the corporate tax rate to 30% would lower the value to 7.5 cents in the dollar. Re-introduction of the 150% rate would simply return the value to 15 cents in the dollar, still only 65% of the 1985 rate.

8.6 Nevertheless, this 150% rate would provide a renewed incentive for industry to encourage growth in our business R&D expenditure at least to the OECD average level. This concession is a market led long term incentive for new businesses to start-up and pursue growth to mature profitable ventures through the application of innovation and continued R&D processes.

8.7 Based on industry experience, small companies would not necessarily gain the same benefit as larger companies in the short term, and tax loss companies may not be able to effectively utilise the R&D Tax Concessions. Consequently, it is recommended that such companies be provided with an option to trade the R&D benefit for cash through a futures market.

8.8 This submission contends that the raising of the Tax Concession to 150% is an essential element to stimulate growth and that, combined with CGT targeted to Registered Innovative Ventures and direct government funding, will maximise growth and hence revenue benefit.

9. Decrease of R&D Tax Concession would reduce business expenditure on R&D

9.1. The Australian corporate sector is still, anecdotally, `a reluctant bride' in investment in R&D. The reduction from 150% to 125% R&D taxation concession has reduced the corporate enthusiasm for R&D. Major companies, especially, have focussed on short term returns rather than long term growth. Large public companies, driven by franked dividends, are particularly sensitive to the amount of funds devoted to longer term R&D.

9.2. Transnational corporations with activities in Australia, generally carry out the majority of their R&D in `home country' bases, and only do in Australia that which is needed for specific local markets, or that for which there is a definite and quantifiable commercial benefit.

9.3. Any further reduction in the R&D Tax Concession would drive companies away from R&D and the growth that ensues.

9.4. Most importantly, **both the rate of the tax concession and the definition of R&D must be 'stabilised' and have consistent long term interpretation so that companies of all sizes can be assured that long term projects, involving substantial technical and commercial risk, are not prejudiced. This submission contends that a project, which commences as R&D, continues to be R&D until completion of the year in which it is commercialised in a production environment with substantial sales to the market place (see also Para 1).** The adoption of this approach will provide assurance to companies that the risks are recognised, and will reduce the number of projects that are stalled prior to commercialisation due to the doubt over tax treatment of the risk expenditure.

CRATMA MEMBER COMPANY	**CONTACT**	**COMPANY INFORMATION**
Auspace Limited PO Box 17 MITCHELL ACT 2911 Ph: 6242 2614 (direct) Fax: 6241 6750 (Ph 622 2613 – Shirleyanne Myers)	Mr Roger Franzen General Manager	Design, integration and analysis of spaceborne communications and observation systems for civil and military applications.
Australian Scientific Instruments (ANUTECH Pty Ltd) PO Box 857 (111 Gladstone Street) FYSHWICK ACT 2609 Ph: 6280 7570 Fax: 6280 4985	Dr Andrew Rastawicki	Specialised scientific instruments used in dating rocks and earth samples.
Canberra Machining Company 75-81 Wollongong St FYSHWICK ACT 2609 Ph: 6239 1439 Fax: 6239 2860	Mr Dean Davidson	The planning and production of mechanical components used in the Research & Development industry in the ACT.
Can-Fab Engineering PO Box 409 (88-90 Gladstone St) FYSHWICK ACT 2609 Ph: 6280 6300 Fax: 6239 1126	Mr Ted Barrington	High precision sheet metal fabrication.
CEA Technologies Pty Limited PO Box 1095 (65 Gladstone St) FYSHWICK ACT 2609 Ph: 6213 0000 Fax: 6213 0013	Mr David Gaul	Radar processing and surveillance systems, data fusion and display systems and software, antenna and communications systems, electronic warfare systems, systems design and integration, modeling and simulation.
Compucat Pty Ltd Cnr Canberra Ave & Mildura St FYSHWICK ACT 2609 Ph: 6295 1331 Fax: 6295 1855	Mr Bill Kearney	Manufacture of special purpose IT communications equipment for secure communications systems including installations, manufacture of rugged IT communications equipment for military purposes, data loader recorders and special purpose hardware for vehicle tracking and GPS-based systems.

Dynjab Research Pty Ltd PO Box 530 (Unit 3/15 Geelong St) FYSHWICK ACT 2609 Ph: 6239 1580 Fax: 6239 1581	Mrs Cilla Dalton	Production line producing passport reading equipment for airports and such things as Board layouts used in research & development.
Electro Optic Systems Pty Ltd Locked Bag 2 PO Queanbeyan NSW 2620 Ph: 6299 2470 Fax: 6299 2477	Mr Ron Thompson	Satellite laser ranging systems; laser rangefinders and tracking systems; fire control systems; telescopes and optical systems; electronics sub-systems; night vision systems.
Endurance Electronics P/L PO Box 422 FYSHWICK ACT 2609 8 Wiluna Street Fyshwick ACT 2609 Ph: 6239 2929 Fax: 6239 1636	Mr David Malloch	Production of Security Equipment
Lintek Pty Ltd 20 Bayldon Rd QUEANBEYAN NSW 2620 Ph: 6299 1988 Fax: 6297 6958	Mr Steve Butler	The manufacture of Printed Circuit Boards using the unique vacuum plasma technique. PCBs are the basic building block for all electronic equipment.
NR Pty Ltd 125 Gladstone St FYSHWICK ACT 2609 Ph: 6280 7521 Fax: 6280 7542	Mr Ian Nicholls	Electronic Warfare Equipment, Systems Integration Equipment and software user interfaces.
Pro-Parts Unit 2/74 Townsville St FYSHWICK ACT 2609 Ph/Fax: 6280 6250	Mr Phil Henderson	The latest technology in computer numerical control machining.
Sustainable Technologies Australia Ltd 11 Aurora Ave QUEANBEYAN NSW 2620 Ph: 6299 2592 Fax: 6299 1698	Dr Gavin Tulloch	The development and manufacture of sustainable technologies/products such as solar cells and energy efficient glazing, lighting and inverters.
AOFR Pty Limited PO Box 7125 Canberra Mail Centre ACT 2610 (2 Faulding St	Dr Scott Rashleigh	Manufacturers of fibre optic components for telecommunications.

Symonston) Ph 6206 2222 Fax: 6280 6393		
COMS 21 Ltd 10-12 Cohen St BELCONNEN 2615 Ph: 6251 1333 Fax: 6251 1666	Mr John Ashcroft	Smart card technology.
ANUTECH Pty Ltd GPO Box 4 Canberra 2601 Tel: 6249 2329 Fax: 6257 1433	Dr John Bell (Maryanne)	Technology commercialisation through licensing, spin-offs and joint ventures; and consultancy.
J W Manufacturing 8 Mana Place Giralang ACT 2911 Tel: 6241 5518 Fax: 6241 0431	Mr John O'Reilly	Contract PCB assembly specialising in surface mounting but will take on whole projects.
Newton Pty Ltd GPO Box 722 Canberra 2610 Tel: 6241 3544 Fax: 6241 2952	Mr Elmo Jacob	Electronic and software engineering.
Westgroup International PO Box 1661 Fyshwick 2609 Tel: 6280 4439 Fax: 6280 4425	Mr Kevin Dwyer (General Manager)	Import, assembly and wholesale of computer memory products and PC card options.
Precision Metals 4 Endurance Avenue Queanbeyan NSW 2620 Tel: 6299 3258 Fax: 6297 5503	Mr Robert Campbell	Sheet metal fabrication for electronic and communications industries.
Westpac Banking Corp Level 5, 1 Farrer Place Canberra 2601 Tel: 6275 5244 Fax: 6275 5259	Mr Andrew McColl	Business Banking Manager
ANZ Bank GPO Box 1473 Canberra 2601 Tel: 6276 4272 Fax: 6276 4240	Mr Will Blackwell	Business Banking Manager
ACTEW GPO Box 366	Mr Neville Smith	General Manager, Business Development

Canberra 2601 Tel: 6248 3070 Fax: 6248 3889		

Australian Business Chamber John McEwan House National Circuit Barton 2600 Tel: 6273 6555 Fax: 6273 6611 ALL MAIL TO: PO Box 2 Civic Square 2608	Ms Jan Williams	
ACT Dept of Business, the Arts, Sport & Tourism PO Box 1000 Civic Square 2608 Tel: 6207 2473 Fax: 6205 0577	Ms Yolanda Hanbidge	
CIT Faculty of Engineering & Construction GPO Box 826 Canberra 2601 Tel: 6207 4046 Fax: 6207 4019	Mr Roger Rose	
Mr John Morphett 5 Gatton Street Farrer 2607 Tel: 6286 6549 Fax: 6286 6549	Mr John Morphett	Honorary Executive Member