Dr Alan Preston
Review of Business Taxation
Department of the Treasury
Parkes Place
CANBERRA ACT 2600

Dear Dr Preston

Submission to the Review of Business Taxation
Research and Development Tax Concession

I would like to thank you, on behalf of the Victorian Research and Development Discussion Group (VRDG), for the opportunity of making a submission to the Review of Business Taxation (RBT).

The VRDG is affiliated with the Taxation Institute of Australia and is committed to representing the interests of Australian companies utilising Government programs to encourage Research & Development (R&D).

Introduction

The VRDG considers it inappropriate to evaluate the R&D tax concession as part of the RBT. This review is based on revenue neutrality and is, in the VRDG's view, not the appropriate forum to demonstrate the net economic and social value of the R&D tax concession, which the Industry Commission concluded after its exhaustive review in 1995.

Notwithstanding this, in view of the RBT's invitation for comments on the R&D tax concession, we detail below our views concerning the need to not only retain the R&D tax concession, but also to restore the R&D tax concession to 150%.

R&D and Innovation

Technological progress is well recognised as the major driver of economic growth. Empirical evidence indicates that technological progress, through its impact on production, is a key determinant of long term economic growth. Technological progress can only be made through an environment that fosters innovation and continuing research and development activities by both the private and public sector.

However, it had been recognised by past governments that investment in research and development was not regarded by the private sector as a top priority. In 1985, the Government introduced the tax concession for research and development. Since that time, the tax concession has been a major factor in the rapid increase in the level of business expenditure on R&D.

The Industry Commission, in 1995, examined the economic impacts of R&D and concluded that, "the estimated aggregate rates of return to Australia's R&D range widely, but are generally high." Further, the Industry Commission concluded that a reduction in the rate of subsidy for R&D will not only lead to a decrease in Federal revenue, but a reduction in GDP.

There is unequivocal evidence that the R&D tax concession has been effective in achieving its original objectives of improving Australia's R&D spending comparative to other OECD countries. The Mortimer Report. "Going for Growth – Business Programs for Investment, Innovation and Export" acknowledges that there is a clear nexus between continuous growth in R&D spending and economic growth and that it is critical that the Government should retain the R&D tax concession in order to promote both short term and long term certainty in business investment in R&D.

There is also evidence that the reduction of the concession from 150% to 125% has directly contributed to R&D projects moving offshore and to the abandonment of other R&D projects. The Business Council of Australia, in its 1998 survey on R&D expenditure, concluded that the fall in the rate of the R&D tax concession has contributed to the dramatic fall in R&D expenditure by one-third in 1998 (or$1.5 billion).

Importantly, a discussion paper released by the House of Representatives' committee on Industry, Science and Resources on 8 April 1999, indicated that R&D spending by Australian business ranks a poor 17th among the OECD countries, although Australia has one of the highest growth rates, over a ten year period, in business spending on R&D. It is evident that other OECD countries have greatly increased their business spending on R&D and, currently, Australia is struggling to achieve the OECD average rate of R&D spending as a percentage of GDP. Recently, many other OECD countries, such as the UK and France, have introduced tax concessions for R&D activities. This highlights the need for the Australian Government to increase its support for R&D in Australia.

There is a real danger that Australia's future prospects for growth and its ability to effectively operate in a global market place in the new millennium will be stifled by ongoing changes to, and uncertainty surrounding, industry policy. The R&D tax concession has a well established infrastructure and, if it is appropriately maintained, is the most effective vehicle for fostering an innovative culture in Australia.

The R&D tax concession has been the central platform of the Federal Government's industry policy and is regarded by Australian business as critical for their continuing investment in R&D in Australia.

A recent “R&D Workshop” was held in Sydney on 24 March 1999. The forum was attended by Australian companies that carry out R&D, researchers and Government. The workshop considered the inputs to innovation, particularly R&D, and its support in Australia. The workshop considered that one of the most effective government commitments to R&D support was through the R&D tax concession, and that this should be restored to 150%. There was a real concern at the possible loss of value in the R&D tax concession, even before a possible reduction to a 30% tax rate. The concession value of the R&D tax concession is directly linked to the tax rate. If the tax rate is reduced, the concession will be marginalised, unless value is added by increasing the rate of concession.

The VRDG considers that the R&D tax concession should not only be permanently retained, but should be increased to at least 150%.

VRDG Survey

In May 1998, the VRDG undertook a survey to assess the effectiveness of current government policy and assistance. The respondents included companies from varying sizes and industry sectors.

The majority of respondents agreed that R&D was considered to be integral to Australian competitiveness and economic growth and that the R&D tax concession has contributed to that conclusion. The survey indicated that investment in R&D paid off through increased revenue, employment, export enhancement and import replacement.

Further, there was strong support for the level of subsidy from the R&D tax concession to be increased to, at least, 150%. The majority of respondents did not believe that direct grants assistance is efficient or effective in allocating support for R&D.

A copy of the survey is attached as part of this submission.

All sectors of industry have communicated their views to the VRDG that the R&D tax concession is an effective means for Government to assist industry with the innovation process.

The R&D tax concession should be integral to any development of industry policy in Australia and should be unambiguously endorsed as a permanent feature of Australia’s taxation system.

Certainty of the R&D Tax Concession

Since the significant changes to the R&D tax concession in 1996, many companies have been reluctant to rely on the concession as a critical factor in R&D investment decisions.

This has resulted from widespread scepticism concerning the Government’s commitment to the R&D tax concession, which has been compounded by the numerous inquiries in relation to the concession.

It is critical that the Government commit to permanently retaining the R&D tax concession to promote certainty of R&D investment decisions in both the short and long term.

Restoration of 150% R&D Tax Concession

If the Government reduced the corporate tax rate to 30%, the total value of the R&D tax concession will fall from the present level of 45 cents for every dollar of R&D expenditure to 37.5 cents.

Recent statistical evidence confirms the adverse effect on R&D spending of the reduction of the concession to 125%. A further reduction of 7.5 cents in the dollar would severely curtail Australia's level of R&D expenditure.

That level of subsidy is unlikely to induce Australian business, in view of present costs of compliance, to invest in R&D.

A reduced level of subsidy will also dilute Australia's attractiveness as a location for R&D investment, particularly relative to other countries which have far more generous R&D tax concessions.

Senator Nick Minchin, in his recent Media Release of 25 March 1999, confirmed the present Government's commitment to the R&D tax concession. This firm commitment requires that the total value of the R&D tax concession be maintained at its present level of 45 cents for every dollar of R&D expenditure.

It is our submission that the Government should restore the R&D tax concession to 150%, if the corporate tax rate is reduced to 30%, to maintain the rate of subsidy of 45 cents in the dollar.

Conclusion

The R&D tax concession should continue to be viewed as a major instrument for encouraging innovation by Australian companies.

Persistent suggestions that the R&D tax concession is to be traded off for lower tax rates creates an environment of uncertainty, thus damaging business confidence in investing in R&D in Australia.

With the increasingly globalised economy and mobile workforce, companies will consider Government assistance and infrastructure as vital factors affecting their decision on the location of their R&D projects.

The R&D tax concession should be integral to any development of industry policy in Australia and should be unambiguously endorsed as a permanent feature of Australia's taxation system.

If you have any questions in relation to the above, please do not hesitate to contact me on (03) 9288 6160.

Yours sincerely

David Gelb (Director, KPMG)
Chairman
TIA - R&D Group