Submission in relation to the:

Treasury Laws Amendment
(Research and Development Tax Incentive) Bill 2019

Inquiry by the Senate Economics Legislation Committee

March 3 2020

Lighting Council Australia Ltd.

Richard J. Mulcahy

Chief Executive Officer

Background

Lighting Council Australia is the peak industry body for lighting in Australia and represents around 100 lighting companies. Many of our members are engaged in the manufacture and design of lighting products. The organisation has members in every State and is overseen by a Board of Directors, comprising of CEO's from many leading Australian lighting companies.

In order to remain competitive, our member companies make substantial investments in Research & Development. The industry already struggles to compete against imported products- many of which are also often not compliant with the Australian rules and regulations observed by Australian companies.

Any reversal of research and development incentives will only serve to harm Australian manufacturing and will inevitably lead to job losses. Additionally in the current economic climate, many lighting companies are finding trading conditions particularly difficult. The recent events in China are now impacting on the supply chain and this will add further pressures to the viability of some lighting companies. The advancement of travel restrictions to many regions will also exacerbate sales and marketing activities for a many of our member companies.

Sales for the Australian lighting industry are estimated at approximately $2 billion annually with a workforce of around 5,000. The majority of our member companies are located in New South Wales, Victoria and Queensland.

Summary of the Proposed R&D Tax Incentive Reforms

It is our view that a number of the changes proposed in the Treasury Laws Amendment (Research and Development Tax Incentive) Bill 2019 ('*the Bill*') pose inconsistencies with achieving greater innovation investment in Australia leading to increased productivity and jobs growth across all states. In failing to adhere to such principles, the proposed policy change risks creating disincentives for innovative businesses to pursue R&D projects and investment in Australia and thus endangers future R&D investment.

Provided below are further details to assist in understanding;

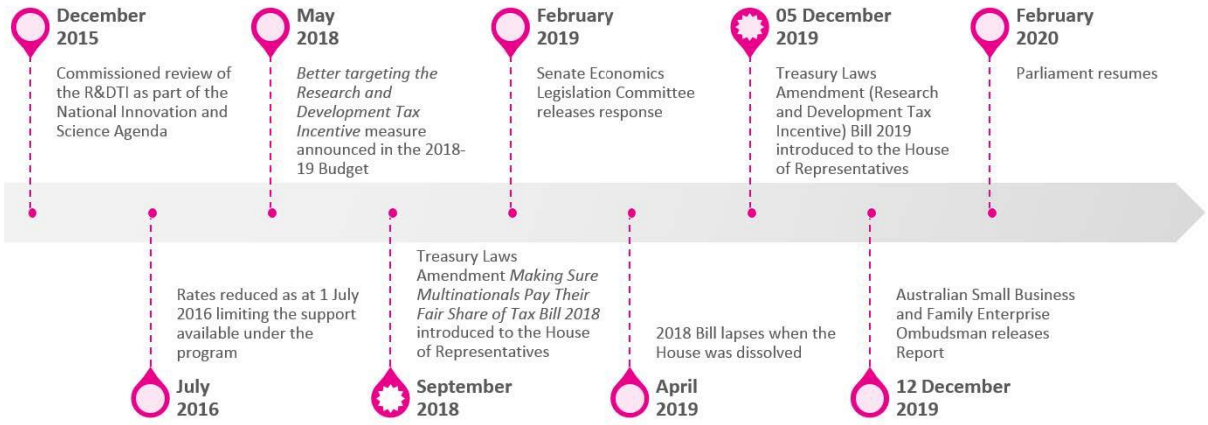
- Magnitude of the proposed legislative changes
- Process to date to implement reform for the R&D Tax Incentive
- Summary of the current proposed R&D Tax Incentive changes
- Analysis of the failings of the reforms in their current state
- Recommendations as to how the objectives of incentivising additional R&D by Australian businesses can be better achieved

Magnitude of the proposed legislative changes

This program has already had some significant cuts and therefore delivered savings to general revenue. The rate of support was reduced for companies by reducing the rate of support at both tiers of the program in 2016 delivering major savings to the Government.

This current Bill has been re-tabled by the Government despite very little change since being rejected by the Senate Economics Legislation Committee as outlined in their report dated February 2019. The Bill will drastically decrease the level of R&D being conducted here and could unfairly disadvantage Australian owned and based R&D companies accessing the higher levels of the program if they have larger operations here in Australia.

Process to date to implement reform for the R&D Tax Incentive



Summary of the current proposed R&D Tax Incentive changes

- An increased cap on annual R&D expenditure able to be claimed from $100mill to $150mill.
- The refundable R&D tax offset rate to be set at the corporate tax rate plus a 13.5% incentive component for claimants with a turnover of less than $20mill.
- A cap of $4mill to be applied to the refundable R&D tax benefit for claimants with a turnover of less than $20mill (with clinical trial exempt from this cap).
- A variable non-refundable R&D tax offset rate to be calculated with reference to an 'R&D intensity calculation' (i.e. R&D expenditure as a proportion of total business expenditure) for claimants with a turnover of greater than $20mill.
- Amendments to the calculation of feedstock expenditure, government recoupments and balancing adjustment amounts that need to be included as assessable income in order to match the new R&D tax offset rates and clawback the incentive component for these items within an R&D claim.

The table below summarises the proposed changes, comparing (1) the proposed bill, and (2) the current program:

Area of legislation	(1) Proposed Bill	(2) Current program,
R&D expenditure cap	$150 million	$100 million
R&D tax offset rate for R&D entities with aggregated turnover < $20 million	Corporate tax rate + 13.5% premium	43.5%
Refund cap	$4 million per annum, excluding expenditure on clinical trials	n/a
R&D tax offset for R&D entities > $20 million	Corporate tax rate + intensity premium	38.5%
Recoupment amounts and feedstock adjustments	An amount of assessable income equal to the grossed-up value of the incentive component of associated amounts of R&D tax offset.	Recoupment amounts are subject to a tax of 10%. One third of feedstock adjustments are included in an R&D entity's assessable income.

Analysis of the impact of the revised R&D intensity calculation for large claimants (>$20mill)

The R&D intensity test proposed for claimants with aggregate turnover greater than $20mill is summarised below, comparing (1) the current R&D rates, (2) the rates proposed in the 2018 Budget, and (3) rates proposed in the current bill:

Amount of R&D expenditure as a percentage of all expenditure	(1) Current R&D tax offset rate	(2) Rate proposed in 2018 Budget	(3) Rate proposed in the current Bill
0% - <2%	8.5%	4%	**4.5%**
2% - <4%	8.5%	6.5%	**4.5%**
4% - <5%	8.5%	6.5%	**8.5%**
5% - <9%	8.5%	9%	**8.5%**
9% - <10%	8.5%	9%	**12.5%**
10%+	8.5%	12.5%	**12.5%**

Primary Failings of the Proposed R&D Tax Incentive changes

1. <u>The changes appear to primarily be a budget saving measure.</u>

    a. There are no current plans or proposals announced to reinvest the savings that the proposed changes will achieve into new forms of direct support for R&D and innovation (as had been suggested by previous recommendations stemming from reviews of the R&D tax program) which are not as effective as key indirect support programs.

    b. Australia's total gross domestic spending on R&D is currently ranked 21st within the OECD and will be further detrimentally impacted by the proposed changes ($1.8billion to be cut over the next 4 years).

2. <u>Significant failings with the proposed R&D intensity calculation to determine tax benefits for companies with turnover greater than $20mill.</u>

    a. Lack of predictability and certainty as to the expected benefit derived from R&D spending given that total business expenditure is a driver of the R&D benefit yet is only confirmed following completion of the financial year.

    b. Additional complexity in calculating the expected benefit via a three-tier intensity calculation which has no similar basis in OECD R&D tax incentive programs.

    c. Discriminatory impact on Australian companies with high levels of business expenditure, as compared with large multinationals/overseas claimants that have smaller onshore operations and reduced total costs in Australia.

    d. Discriminatory impact on businesses and sectors that have low margins and high levels of business expenditure that prevent meaningful increases or control over their R&D spending % - e.g. manufacturers and agribusiness with high input/feed costs, mature businesses with large sales/marketing expenses, business with large capital investment requirements.

    e. A fundamental failure to provide any meaningful incentive for Australian companies to increase investment in R&D as per the stated intent of the changes given the unrealistic investments needed to increase net benefits from the program. For example, claimants with a turnover greater than $20mill will need to achieve an R&D expenditure intensity of 14.1% to achieve an equivalent tax benefit to the current program (8.5 cents per $1 R&D expenditure).

    f. Companies with a turnover of greater than 20MIL will not know what rate of benefit that they will qualify for until after their year-end making investment decisions in R&D difficult and support levels unknown in advance.

g. Rather than promoting increased investment in R&D, the changes promote an incentive to reduce other expenditure to increase the R&D intensity measure. For example, companies have an incentive to relocate operations and operating costs offshore to reduce total Australian expenses.

3. International Competitiveness

a. The Australian lighting industry must compete in a global market. Changes such as those proposed in this Bill will further disadvantage Australian manufacturers.

b. For example, New Zealand has recently increased their R & D allowances, and this may serve to encourage Australian companies to undertake projects within the New Zealand environment and this is not in Australia's interest.

c. The UK is also incentivising Research and Development further and that will see Australian companies disadvantaged in the international marketplace. Other European member states are doing the same.

d. The Lighting Council is firmly of the view that there is nothing in this Bill that will help industry and it appears to be simply a budget savings measure.

Recommendations - Alternative Reforms for the R&D Tax Incentive

Summary of alternative reforms to concurrently reduce the R&D Tax Incentive program cost, whilst encouraging increased R&D investment across Australian business.

Item	Proposed change	Comments
1	Increase minimum spend for eligibility from $20,000pa to $50,000pa (for <$20mill claimants)	Provides a method of reducing the costs of the program
2	Maintain the current 8.5% incentive premium for large claimants (>$20mill turnover), but introduce a $100,000 threshold for >$20mill claimants, with no R&D benefit on the base $100k spend	Provides a method of reducing the costs of the program
3	Remove certain eligible R&D expenditure items from the claim – e.g. feedstock expenditure, depreciation expenditure	No benefit attributable to feedstock expenditure therefore improves administration of the program. Eligible depreciation is difficult to calculate and evidence a connection to R&D
4	Maintain annual R&D expenditure cap at $100mill per annum	The increase to $150mill only provides an advantage to a handful of large claimants

5	Broaden the scope of activities not subject to the $4mill per annum refundable offset cap beyond clinical trial expenditure to include other projects of national importance or broader societal benefit	Offsets the discriminatory application of this aspect of the proposed changes
6	Introduce a collaboration premium of between 10 and 20 per cent for the non-refundable tax offset for R&D expenditure/activity undertaken with publicly funded research organisations	A method of incentivising collaboration with research organisations as per previous reviews and recommendations for the program
7	Introduce a premium or additional benefit for certain activities/costs for projects that result in patentable technology or IP	A method of incentivising the protection of Australian developed IP
8	Maintain the 13.5% incentive component (i.e. an R&D offset of 41%) proposed for claimants with a turnover of less than $20mill, but increase the threshold for SME claimants from $20mill to $50mill	The turnover threshold of $20mill for the refundable R&D offset has been unchanged since the R&D Tax Incentive was introduced in 2011. This change would extend this threshold and correlate the definition of SMEs with the current corporate tax rate reductions being implemented for <$50mill entities
9	Reintroduction of a premium or additional benefit for large claimants (>$20mill) that are able to increase annual R&D expenditure against a prior three-year average	Similar to the 175% premium concession available to companies under the previous R&D tax concession program, this provides the most effective means of encouraging year on year growth in R&D expenditure.