



Alla submission on Treasury Laws Amendment (Making Sure Multinationals Pay Their Fair Share of Tax in Australia and Other Measures) Bill 2018

5 November 2018

Level 1, 131 Canberra Ave
Griffith ACT 2603
Australia

61 2 6281 9400
info@aiaa.com.au
www.aiaa.com.au

About AIIA

The Australian Information Industry Association (AIIA) is the peak national body representing Australia's information technology and communications (ICT) industry. Since establishing 35 years ago, the AIIA has pursued activities aimed to stimulate and grow the ICT industry, to create a favourable business environment for our members and to contribute to the economic imperatives of our nation. *Our goal is to "create a world class information, communications and technology industry delivering productivity, innovation and leadership for Australia".*

Our membership includes global brands such as Apple, EMC, Google, IBM, Intel, KPMG, Microsoft, CISCO, Infosys, WIPRO and Oracle; international companies including Telstra, Optus; national companies including Data#3, Veritec and Oakton Limited; and many ICT SME's such as Silverstone Edge and Zen Enterprise and Start-ups such as OKRDY.

AIIA's Policy Priorities and the R&D Tax Incentive Scheme

One of the top policy priorities for AIIA is Innovation and ensuring that government policies and legislation support ongoing innovation in the ICT sector in Australia.

Australia's position in the Global Innovation Index has gone down from 18 to 20 from 2010 to 2018. Australia is behind leaders such as Switzerland, UK, Sweden, US, Finland and Singapore. We are also below closer economies such as that of New Zealand, Hong Kong and Korea.

According to the 2018 Australia's Digital Pulse Report, Australia currently ranks number 12 out of the 16 countries surveyed on business expenditure on research and development in ICT. This investment needs to be fostered rather than hindered. If Australia does not have an internationally competitive R&D tax system, companies will move to other jurisdictions where R&D tax schemes are more favourable. This will have flow on effects for

- Innovation in the ICT sector in Australia;
- STEM skills development and application and preparedness for jobs of the future; and
- Australia's ICT exporting capability;

Furthermore, the flow on effects will also impact on the Australian government achieving its targets such as:

- becoming one of the top three countries in the world for Digital Government by 2025; and
- developing emerging and future technologies for the future defence force (Defence Industry Policy Statement 2016).

In October 2018, Startup Muster's annual online survey has also found that while there were 1,675 startups in 2017, this number dropped to 1,465 in 2018, a 12.5 per cent decrease in one year. It also found that while there 1,291 startups launched between the 2016 and 2017 report, there were only 712 launched in the last year.

The proposed changes to the R&D tax legislation which are to take effect retrospectively from 1 July 2018, does not foster innovation through research and development in Start-ups, SMES or large organisation operating in Australia.

Summary of our Submission

The focus of our submission is on Schedules 1 to Schedule 3 and relate to the following three areas:

1. The proposed changes will have a negative impact on Australian Start-ups and SMEs for the Refundable benefits.
2. The complexity of the tier based intensity model for Non-Refundable benefits will drive large businesses off shore.
3. The proposed legislation will create a higher compliance burden, especially on Start-ups and SMEs.

4. A collaboration premium for expenditure with a research organisation should be introduced to foster greater collaboration between industry and research institutes. This would be consistent with the four pillars of the National Innovation and Science Agenda.

1. Impact on Australian SMEs

The proposed amendment sets the tax benefit to 13.5% above the prevailing company tax rate. This means that the offset rate will no longer be a set number (currently 43.5%). A Refundable Offset taxpayer's rate is the addition of its company tax rate plus the 13.5%. So, refundable claimants with a 30% company tax rate (currently group turnover of \$10-20 million) continue to have a rate of 43.5% while those with a company tax rate of 27.5% (\$0-10 million) will now have a rate of 41% so the eligible cash back on claimed R&D spend will be lower than currently.

The fact that National Start-ups and SME's with less than \$10 Million turnover, especially those with \$1 million or less turnover, will be eligible for a lower amount of cash refund seems to be counter intuitive to an R&D scheme that is trying to incentivise research and development.

The testimonials attached draw attention to this adverse effect on National SMEs who currently benefit from the scheme.

2. The complexity of the tier based intensity model for Non-Refundable benefits

Our members believe that the intensity based model does not support a culture of R&D in ICT in Australia.

The reasons for this include but are not limited to:

- a) the complexity of the tiered approach. The complexity of the tiered approach means that the claimants are unable to determine their R&D benefit before they commit to the activities. This means that the incentivising aspect of the scheme is reduced;
- b) under the proposed model, applicants will have difficulty in determining which tier of intensity they might fall into at any time during their income year. The company's intensity Tier can only be calculated at the end of an income year when R&D and total expenditure can be determined. Therefore, the scheme proposed is more like a rebate on the past years' R&D activities rather than an incentive;
- c) the flow on uncertainty will mean that companies cannot predict the R&D incentive they will receive in advance and this will discourage additionality;
- d) the proposed scheme is likely to discourage our members from undertaking R&D activities in Australia and instead move such activities to jurisdictions where R&D schemes are less complex and flat structured, pose less of a compliance challenge and provide greater certainty on eligible refunds;
- e) the maximum benefit under the intensity calculations is less than 12.5 benefit which will put Australia's R&D benefits behind our neighbours such as what is being proposed in New Zealand;
- f) the tiered approach is not in keeping with R&D tax incentive regimes in other countries; and
- g) Expenditure cap on the numerator has a negative impact and does not encourage additionality or growth of the company. It provides a disincentive for very large businesses conducting R&D even at high intensity. Should a company spend more than \$150m on eligible R&D expenditure in a given income year, the excess above \$150m would not be included in the R&D offset numerator and would instead be treated as an offset at the entity's corporate tax rate. Therefore, above \$150m there would not be any tax incentive to conduct R&D activities.

3. The proposed legislation will create a higher compliance burden, especially on SMEs, because of the level of complexity.

Under the government's Deregulation Agenda, the government is focusing on reforms that remove barriers to competition, innovation and growth, building on the ongoing commitment to cut red tape, improve regulator performance, and strengthen Regulatory Impact Analysis processes.

However, the proposed changes and its retrospective application from 1 July 2018, adds barriers to innovation especially for Start-ups and SMEs who do not have the in-house resources or the financial resources to ensure that they are abreast of the proposed changes and meet all the compliance requirements.

The justification for the retrospective application of the proposed changes have also not been made clear.

Additionally, the behaviour of some outlier applicants appears to have given AusIndustry and ATO the licence to be particularly aggressive in their audit and compliance activities. While AIIA members support regulator performance, transparency and simplification of requirements and guidance material developed in consultation between agencies and industry would remove barriers to innovation and cut compliance red tape.

The ATO and AusIndustry Guidance Material for Software Development Activities

Our members are currently waiting for the release of the new guidance material on software development activities.

Our members, especially those specialising in software development, are concerned about the following:

- a) AusIndustry's narrow view of eligibility. For example, earlier guidance acknowledges that testing, implementing and integrating could be registered as eligible core R&D activity. However, now only 'developing' is treated as a core activity.
- b) software guidance material will be applied retrospectively on R&D entities;
- c) documentation requirements lack clarity. There is no practical guidance from the ATO or AusIndustry in relation to how to meet the support documentation requirements in a commercial context; and
- d) all activities need to be 'recorded' as R&D at the time they are conducted. Unless the document includes the word 'hypothesis' - like a formal academic R&D exercise, the activity is not accepted. This suggests that research from tertiary institutions have been used as a benchmark for this requirement without reference to industry and Startups and agile practices. The reality is, companies are different to research institutions and simply do not keep formal academic records of their R&D exercises with a view to publishing articles on their research. For industry, these documents will need to be created specifically for compliance with the scheme and will add to their compliance cost.

The consequences of R&DTI uncertainty on our software developers members means that they are starting to look at overseas jurisdiction such as New Zealand where the R&D tax incentives are less complex and more generous. The move to relocate R&D activities offshore is proving to be an unintended consequence of the proposed reform and will have a negative impact on innovation, STEM skills development and growth of the ICT businesses in Australia and the Australian government's target of digitising government and having future ready defence force.

Therefore, we recommend that Government require AusIndustry and ATO engage with both our members and software developer Start-ups and vendor communities to develop R&D Guidance material for this sector.

4. Collaboration premium should be introduced

A collaboration premium would allow all applicants (regardless of their R&D Intensity) to access a premium benefit and encourage further collaboration between research organisations and industry. The benefits of such an approach would include:

- a) a flat premium, regardless of a claimant's R&D Intensity and provide certainty to applicants;
- b) it is simple and industry agnostic, without favouring local / overseas companies;
- c) it is a premium amount and it should be globally competitive; and
- d) it encourages additionality in R&D collaboration with universities and research organisations, supporting Australian science and innovation and the activities will provide the largest spill over benefits with skills development, job generation and commercialisation of R&D.

We would be happy to meet with the committee to discuss our submission.

Kind regards,

Kishwar Rahman
GM Policy and Advocacy

Australian Information Industry Association

Office 4, 131 Canberra Avenue, Griffith ACT 2603

M: 0498 807 238 P: 02 6281 9402 | k.rahman@aiia.com.au | www.aiia.com.au

