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Committee Secretary  
Senate Economics Legislation, SG. 64  
PO Box 6100  
Parliament House  
Canberra ACT 2600

13 October 2014

Dear Sir/Madam

#### **INQUIRY INTO TAX AND SUPERANNUATION LAWS AMENDMENT (2014 MEASURES NO.5) BILL 2014**

BDO welcomes the opportunity to provide a submission to the Senate Economics Legislation Committee inquiry into the provisions of the Tax and Superannuation Laws Amendment (2014 Measure No.5) Bill 2014. Please note that our submission is only in respect of Schedule 3 to this Bill.

Schedule 3 to this Bill proposes to amend the *Income Tax Assessment Act 1997* (ITAA 1997) to reduce the rates of the tax offset available under the research and development tax incentive by 1.5 percentage points. This change is to apply to income years commencing on or after 1 July 2014.

Our submissions are as follows:

- The proposed reduction in the tax offset rates could be damaging to the Australian Innovation system for the following reasons:
  - Australian based companies conducting R&D rely on financial incentives as a benefit for undertaking innovative, experimental and high technical risk projects. Reducing the rate, reduces the benefit for companies considering conducting work of this nature and therefore may result in less innovative projects being conducted to the detriment of the Australian economy
  - A rate reduction suggests to the wider Australian economy that the R&D Tax Incentive is an unreliable support system. This creates additional risk regarding the financial viability of conducting an innovative project as a company cannot rely on the incentive system not to change for the life of a project. This may prevent companies conducting innovative projects and is therefore damaging to the perception of the program within industry
  - Innovative start-up companies in the early stages of operation rely on the refundable R&D Tax offset to maintain positive cash-flow before they have a revenue stream. A reduction to the benefit will directly affect that cash-flow position and will present more challenging conditions for start-up companies, in an already challenging market, also deficient in alternative forms of early stage funding



- The rate reduction makes conducting R&D activities within Australia less favourable as compared to other jurisdictions
- The explanatory memorandum to the Bill states that “*the reduction in the tax offset rates is consistent with the Government’s commitment to cut the company tax rate from 1 July 2015 by maintaining the relative value of the offsets.*” Accordingly, it should follow that any reduction in the tax offset rate also take effect from the same date as the reduction in the corporate tax rate
- Per the former Government, the key driver to change the delivery of the incentive from additional deductions to a tax offset was for the very purpose of decoupling the incentive from the corporate tax rate thereby improving investment certainty
- In a practical sense, the reduction in rates complicates the calculation of the incentive and creates anomalies
- In particular, the Bill, as currently drafted, makes no provision for consequential amendments to Subdivisions 355-G and 355-H of the ITAA 1997, nor Section 12B of the Income Tax Rates Act 1986 for the period before the corporate tax rate is reduced. Subdivision 355-G operates to “clawback” the incentive through an increase in tax payable where a Government grant has been received. Subdivision 355-H makes an adjustment to assessable income to “clawback” the incentive received on feedstock inputs where a company sells or otherwise applies to its own use a marketable product it has created. In effect, these provisions are designed to clawback the 10% incentive component afforded under the current 40% non-refundable tax offset. Whilst we note that the explanatory memorandum states that no change has been made to these provisions “for simplicity”, as illustrated in the examples provided at Appendix A, reducing the incentive component to 8.5% and not amending these provisions creates an absurd situation where companies may in fact be penalised for undertaking eligible R&D activities.

Accordingly, whilst we do not support any reduction in the R&D tax offset rates, at a minimum any reduction should only take effect in line with a reduction in the corporate tax rate.

Should you have any questions, or wish to discuss any of the comments made in these submissions, please do not hesitate to contact me

Yours sincerely

**BDO (QLD) Pty Ltd**

Nicola Purser  
Director



## Appendix A

### Example A - Subdivision 355-G: Clawback

Company A has an aggregated turnover greater than \$20m. It has assessable income of \$500,000. During the year it incurs \$200,000 on R&D activities but also receives \$100,000 in matched funding from the Government to undertake that activity.

Set out below is the tax treatment of this simplified example in the absence of a tax incentive, with the tax incentive as it currently stands and if this Bill is enacted in its current form.

	No R&D Incentive	FY14 (current)	FY15 (proposed)
Assessable Income	\$500	\$500	\$500
Deductions	(\$200)	\$0	\$0
Taxable Income	\$300	\$500	\$500
Tax Payable before offsets and additional tax payable	\$90	\$150	\$150
R&D tax offset	-	(\$80)	(\$77)
Additional tax payable*		\$20	\$20
Net tax payable	\$90	\$90	<b>\$93</b>

\*Subdivision 355-G works to levy additional income tax based on expenditure incurred on the relevant activities. The rate of additional income tax is set out in Section 12B of the Income Tax Rates Act 1986 and is currently 10%.

In this simplified example, under the proposed amendments and with no adjustment to Section 12B of the Ratings Act, Company A would in fact pay more tax than it would in the absence of any R&D tax incentive.



**Example B - Subdivision 355-H: Feedstock**

Company B has an aggregated turnover greater than \$20m. The Company undertakes R&D activities and through that process creates a marketable product. Company A sells the product for \$500,000. In creating the product it incurs the following expenses: Feedstock input \$100,000 other non R&D expenditure \$100,000.

	No R&D Incentive	FY14 (current)	FY15 (proposed)
Assessable Income	\$500	\$533.33*	\$533.33*
Deductions	(\$200)	(\$100)	(\$100)
Taxable Income	\$300	\$433.33	\$433.33
Tax Payable before offsets	\$90	\$130	\$130
R&D Tax Offset	-	(\$40)	(\$38.5)
Net tax payable	\$90	\$90	<b>\$91.50</b>

\*Per Subdivision 355-H where a company has incurred expenditure on feedstock inputs and the feedstock output (marketable product) is sold or applied to the entity's own use, then the company is required to make an adjustment to assessable income of 1/3 of the lesser of the feedstock revenue or feedstock input. In this case the lesser amount is the feedstock input and accordingly 1/3<sup>rd</sup> of that amount is included in assessable income.

With a 30% corporate tax rate, the 1/3<sup>rd</sup> calculation results in a clawback of the 10% incentive component. By reducing the incentive component to 8.5%, but retaining the corporate tax rate at 30% the 1/3<sup>rd</sup> calculation means that the amount clawed back is greater than the incentive provided. This again creates the absurd position that the company would pay more tax than in absence of a tax incentive.