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5 November 2018

Dear Sir/Madam

TREASURY LAWS AMENDMENT (MAKING SURE MULTINATIONALS PAY THEIR FAIR SHARE OF TAX IN AUSTRALIA AND OTHER MEASURES) BILL 2018

BDO welcomes the opportunity to provide feedback in response to the proposed R&D Tax Incentive amendments that form part of the provisions of the Treasury Laws Amendment (Making Sure Multinationals Pay Their Fair Share of Tax in Australia and Other Measures) Bill 2018 that was introduced to Parliament on 20 September 2018.

Should you wish to discuss any of our comments, please feel free to contact me on [redacted].

Yours sincerely
BDO (QLD) Pty Ltd

[redacted]

Nicola Purser
BDO National R&D Leader

Executive Summary

The Senate Standing Committee on Economics has sought feedback and comments from Industry on Treasury Laws Amendment (Making Sure Multinationals Pay Their Fair Share of Tax in Australia and Other Measures) Bill 2018 ('the bill'). A significant number of the provisions in this bill relate to amendments to the R&D Tax Incentive (R&DTI).

It is our view that if the proposed changes to the R&D Tax Incentive were to be introduced in their current form they would be detrimental to Australian taxpayers and accelerate the decline in Australia's 'Business Expenditure on R&D' (BERD). Further, while the bill will improve the fiscal affordability of the R&DTI by limiting the offsets available to taxpayers, it does little to improve the targeting or integrity of the programme.

BDO's key concerns and recommendations are as follows:

1. **Improve industry equality:** The proposed provisions will create disparity in the support provided to taxpayers in different industries. Key provisions including the 'intensity test' should be re-evaluated to ensure they promote industry equality.
2. **Reduce complexity:** The proposed changes such as the 'intensity test' and 'clawback provisions' introduce greater complexity and reduce the overall value of the R&DTI due to the additional cost of compliance for all programme stakeholders. If the provisions are retained, they should be simplified and provide taxpayers with an opportunity to take low-burden routes (eg. opting-out of the 'intensity test' and instead take the minimum offset rate).
3. **Ensure a sufficient benefit is provided:** The increased cost of compliance combined with the reduction in offset rates may negate the benefit of the programme for some taxpayers. The government should maintain a minimum after-tax benefit of 15% for SMEs and 7.5% for large entities and the maximum threshold for the refundable tax offset should be increase to $150 million.
4. **Adjust timing and introduce transition rules:** Many taxpayers have already planned and committed expenditure to R&D projects over future income periods based on the current provisions. Any proposed changes should be implemented for income years beginning after 1 July 2019. Further, any significant changes such as the $4 million cap on the refundable offset should include transitional rules that mitigate the immediate impact on taxpayers.
5. **Separate bill schedules:** The proposed changes to the R&DTI do not align with the broader purpose of the omnibus bill of *'Making Sure Multinational Pay Their Fair Share of Tax'*. We recommend that schedules with a limited nexus to multinational tax affairs, such as those relating to the R&DTI, should be removed and considered in their own right.

The following response provides further commentary about the design, function and impact of the proposed changes to the R&D Tax Incentive and includes further recommendations for improving the programme.

Contents

Reforming the Research and Development Tax Incentive

The proposed changes to the R&DTI are based on some of the recommendations that came out of its 2016 review of the R&DTI and the subsequent 'Australia 2030: Prosperity through Innovation Report' ('The Review') released in January this year by the Board of Innovation and Science Australia (ISA). The Review found the Incentive was failing to fully achieve its objectives of generating additional R&D activities, was not well targeted, providing benefits for R&D activities that would have been undertaken without the Incentive, and the cost was exceeding initial estimates. The proposed changes are intended to improve the targeting of the Incentive and are estimated to have a net gain to the budget of $2.4 billion in fiscal balance terms over the forward estimates period.

According to ISA, the top priority of Australia's innovation policy should be to increase business expenditure on R&D to push us to the forefront of the global innovation race. Our view is that, in the current climate where both business expenditure on R&D (BERD) in Australia and the cost of the R&DTI is falling, a $2.4 billion reduction in innovation support will in our opinion, not be able to achieve the policy objectives, but most likely, achieve the opposite. The type of additionality that the Federal Government (Government) wants to see enhanced are activities that are well planned and go beyond so called 'business as usual' activities. However, in our opinion, not only is the Governments frame of reference in seeking additionality based on a static, rather than dynamic, concept of what 'business as usual' activity entails, genuine 'additionality' that raises the overall level of BERD will unlikely be achieved through the proposed measures. Indeed, the proposed measures will skew assistance toward companies 'business as usual' activities rather than genuine additionality within a dynamic business investment framework.

During the 2016 Review of the R&DTI programme BDO has previously emphasised the need to ensure that the administration and compliance burden on industry is minimised, whilst also meeting the Government's Science and Innovation agenda. The increased complexities and compliance requirements associated with identifying eligible activity and expenditure under the proposed changes to the programme, in our opinion, are likely to offer little to no incentive for companies to access the R&DTI program, particularly those with a group turnover over $20 million.

Furthermore, whilst the existing R&DTI that was introduced to replace the R&D Tax Concession provides certainty and has led to activities that have generated new solutions and improved efficiencies for Australia, this is the second time since the R&DTI was introduced that the government has made changes to the programme. A continually changing R&D programme makes it difficult for many innovators to plan their R&D strategically particularly at a time when governments in other jurisdictions are increasing their support of innovation. Furthermore, the changes introduce a number of measures that will only allow the tax benefit to be identified retrospectively.

We highlight some of our concerns with the proposed changes below, and would urge the government to reconsider introducing these measures in their current format.

BDO's key concerns with the function and administration of the provisions

Efficacy of the intensity test

A major feature of the new proposed changes to the R&D Tax Incentive is the introduction of a variable rate of assistance for large companies depending on their level of 'R&D Intensity'. Intensity is determined as the ratio of expenditure on R&D to total company expenditure. It is useful to note that a large company will need to have an R&D Intensity of 13% in order to receive the same 8.5% tax benefit currently applying to large companies.

As a result, the vast majority of large company claimants of the R&D Tax Incentive will receive a reduced level of taxation subsidy under the R&D Intensity Test than the current fixed 8.5% benefit. We note that at 8.5% Australia already provides one of the lowest R&D tax subsidies for large entities across all OECD countries offering a volume-based R&D tax credit, with the mean subsidy for large profit-making companies across the OECD is 13%.[1] Under the proposed intensity test this subsidy will drop to just 4-6% for a majority of large taxpayers, making Australia the least attractive jurisdiction in the OECD for entities that are conducting R&D activities.

Apart from the level of assistance, the other major problem with the R&D Intensity Test is that it is a complicated calculation, based on incremental rates of assistance applied on a marginal basis. This intensity can vary significantly depending on the industry resulting in a disparity in the level of support provided, particularly for those in low-margin, high-volume industries such as agriculture, manufacturing and mining.

Table 1 on the following page provides four examples of companies that represent typical taxpayers within their respective industries and demonstrates how the new intensity test would affect the R&D offset they receive. As can be seen, taxpayers with high operating costs and overheads will lose up to half their benefit compared to current 8.5% rate, while those in low overhead industries are only slightly better off.

It further highlights the difficulties an entity would have with 'increasing their R&D intensity' as the new measures intend. For example, if Company A were to double its R&D spend to $4.8 million while maintaining the same total company expenditure:

- Its 'R&D Intensity' would increase from 2.6% to 5.1%; however,
- Its effective offset would only increase from 34.6% (4.6% after-tax benefit) to 35.6% (5.6% after-tax benefit)

Even after doubling its R&D intensity Company A will still receive substantially less under the new provisions compared to the current 8.5% after-tax benefit.

This is also by no means restricted to companies with a high operating cost. If Company D were to double its R&D expenditure, its effective offset would only increase marginally from 39.8% to 41.1%.

[1] OECD REVIEW OF NATIONAL R&D TAX INCENTIVES AND ESTIMATES OF R&D TAX SUBSIDY RATES, 2017

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Table 1: Comparison of large profit-making taxpayers

	Company A	Company B	Company C	Company D
Industry	Agribusiness	Manufacturing	Technical Services	Software Development
Company Expenditure				
Cost of Goods Sold	75,800,000	23,900,000	3,200,000	2,100,000
Other Expenditure	17,200,000	15,200,000	21,500,000	23,940,000
Total Company Expenditure	**93,000,000**	**39,100,000**	**24,700,000**	**26,040,000**
Total R&D Expenditure	**2,400,000**	**1,500,000**	**5,300,000**	**5,040,000**
R&D Intensity	**2.6%**	**3.8%**	**21.5%**	**19.4%**
Current Effective Offset	38.5%	38.5%	38.5%	38.5%
Current After-Tax Benefit	**204,000**	**127,500**	**450,500**	**428,400**
New Effective Offset Rate	34.6%	35.2%	40.1%	39.8%
New After-Tax Benefit	**109,500**	**77,950**	**532,825**	**493,290**
Gain / (Loss)	**(94,500)**	**(49,550)**	**82,325**	**64,890**

Recommendation

- Increase the minimum tax subsidy offered from 4% to 7.5% to ensure Australia remains an attractive jurisdiction on an international stage to conduct R&D activities
- Rather than an intensity test based upon business expenditure, the intensity test should reward companies that increase their investment on R&D activity similar to the 'premium' under the R&D Tax Concession. This would be a more industry agnostic approach to rewarding further investment in R&D activity

Clawback for R&D recoupments, feedstock adjustments and balancing adjustments

The EM acknowledges that the current clawback recoupment and feedstock provisions only partially reverse the benefit of an R&D tax offset in some circumstances, and produce an anomalous outcome if not amended.

However, the EM does not explain that the anomalous outcome is a result of the reduction in corporate tax rate, such that the 10 percentage point clawback penalises those entities that receive recoupments or have feedstock adjustments when they access the non-refundable offset.

It does not explain that the recoupment clawback and feedstock provisions were designed to provide at least 5 percentage points of incentive for those entities that receive recoupments or have feedstock adjustments when they access the refundable offset. The incentive mechanism in the current recoupment and feedstock provisions therefore encourages companies, and particularly those that qualify for the refundable tax offset, to conduct activities that might otherwise not be conducted because of an uncertain return from the activities in line with the object of the Division.

Despite the fact that the EM states that the remaking of these provisions is 'not intended to alter the way' recoupment amounts or feedstock adjustments are calculated, the EM explains that the intention of introducing a uniform clawback rule is to ensure that an R&D entity 'disgorges the entire benefit of an R&D tax offset to the extent it (or a connected entity or an affiliate entity where appropriate) receives a recoupment amount, feedstock adjustment or assessable balancing adjustment because of the offset.' The 'disgorging' of the entire benefit of an R&D tax offset in the new provisions clearly do not align with the original intention of the current recoupment and feedstock provisions, nor do they align with the object of the Division.

The operative provisions of the new Subdivision introduce a new uniform clawback rule that not only applies to recoupments and feedstock adjustments, but also balancing adjustment amounts. The proposed changes introduce a new complicated formula which compares the offset claimed with the amount that would have been received if notional deductions were reduced by the clawback amounts calculated for the income year. However, the mechanism proposed is cumbersome and unnecessarily complex, requiring claimants to incur increased administration costs in order to calculate the clawback to be included in assessable income. Furthermore, despite guidance published by the ATO and AusIndustry in 2015 'Can an R&D entity choose not to claim feedstock input and avoid feedstock adjustments?', no specific provision has been included to allow entities to 'opt-out' of applying the clawback in respect of feedstock.

The Subdivision also introduces a complex catch-up amount rule that applies when a deductible balancing adjustment amount arises for an R&D asset. The catch-up rule mirrors the operation of the new uniform clawback rule, reversing the incentive component of claiming depreciation associated with assets used in R&D activities. Such deductions will now be real deductions rather than notional R&D deductions, which means that going forward, these can only create tax losses rather than refundable tax offsets. The EM explains that the rationale for the new catch-up amount rule is to replace existing rules that estimated the incentive component of the R&D tax offset that need to be clawed back. It is unclear how the incentive component is 'estimated' under the current law since a balancing adjustment event occurs after an asset is sold, thus the purchase and sale price are known. Furthermore, since the performing of R&D activities is more likely to trigger a deductible balancing adjustment (such as when an asset is destroyed in the R&D activity), the new provision does not align with the object of the Division. It does not encourage companies to conduct activities that might otherwise not be conducted because there is no incentive provided on the loss of any such assets used in the R&D activities.

These new measures will reverse the entire benefit associated with obtaining recoupments, incurring expenditure on materials processed or transformed into tangible products, or selling an asset at a reduced cost after the R&D activities. Instead of encouraging additionality and spillovers associated with conducting experimentation to create new knowledge, these amendments will increase the administrative burden of undertaking such activities and decrease the attractiveness of performing experimental activities.

Recommendation

- Retain an incentive component of 5 percentage points for entities that qualify for the refundable offset
- Provisions should be provided to allow entities to opt in or out of including feedstock/recoupment/balancing adjustment expenditure as R&D expenditure. Ideally this expenditure could still be included in the numerator of any R&D intensity calculation
- Provide more realistic and accurate examples of how the changes will operate in practice.

Retrospective Start Date

If the proposed legislation is passed, a retrospective start date of 1 July 2018 will be incorporated in relation to the new benefit.

A majority of applicants would have planned their activities for the 2019FY under the assumption that they would receive a certain R&D Tax offset following the completion of the 2018FY claim. In a large number of cases, the amount will drop significantly, thereby putting planned work in jeopardy

Recommendation

- Any changes to the R&DTI should apply from 1 July 2019.

BDO's key concerns with the provisions' impact on industry

Industry favouritism

The R&DTI programme has supported Australian businesses as an industry agnostic incentive for over 30 years. The programme was initially established to provide support to businesses of all sizes and across all industries, with the goal of encouraging innovation and advancement.

The draft legislation introduces for the first time a number of specific provisions that specifically favour certain industries. First, the legislation proposes an exclusion from the proposed $4 million annual rebate cap for the refundable R&D tax offset entitlement of companies undertaking clinical trials (i.e. for companies with a turnover of less than $20 million, there is no limit on the cash refund that can be gained from undertaking clinical trials).

This is a stark contrast to the cash refundable limit of $4 million proposed for all other R&D projects, irrespective of the fact that a lot of clinical trials activity supported by the programme are actually not conducted in Australia. This highlights the heavy focus the government is placing on the advancement of the medical and pharmaceutical industry, as opposed to other sectors conducting R&D in Australia that also contribute significantly to Australia's GDP.

Second, as demonstrated in Table 1, the proposed legislation applying to non-refundable offset recipients discriminates against those businesses which operate in industries characterised by high turnover and low margins (including the manufacturing, agribusiness and resources sectors) through the introduction of a new tiered non-refundable offset. This tiered mechanism will provide proportionately larger R&D benefits to those companies with a high 'R&D intensity'.

Under this tiered offset, companies with a turnover over $20 million will be required to have an R&D intensity of greater than 13% to receive a greater offset than the current 38.5%. This will ultimately be a significant disincentive for companies to innovate, become more efficient and achieve sustainable growth. In our experience, only a handful of companies with a turnover over $20 million could achieve an R&D intensity of greater than 13%.

Recommendation

- Whilst we agree with a cap on the refundable offset that can be obtained in an income year, the R&DTI should remain industry agnostic with no exclusion beyond any cap for any industry.
- We recommend that if a cap is introduced, transition rules apply such that companies that can demonstrate commitment/investment in a project reliant on refunds greater than the $4 million cap be able to apply for exemption from the cap for the budgeted life of that project.
- Rather than introducing an exclusion specifically for clinical trials, ISA should be empowered to lift the cap through findings for projects of national importance. This effectively creates a hybrid between direct and indirect funding mechanisms and improves the flexibility of the legislation to adapt to national challenges.

Reduced investment in innovation support

The proposed changes are being introduced as a means of preventing the cost of the R&DTI programme from ballooning beyond its current $3 billion/year cost, compared to the $1.77 billion allocated at the release of the programme in 2012.

However, recent statistics indicate that the cost of the R&DTI programme has remained constant and when adjusted for inflation has effectively declined since its introduction (see Table 2).

Table 2: R&D Tax Incentive Budget Summary [2]

						Estimated Actual	Budget Estimate
R&D Tax Incentive	**2012-13**	**2013-14**	**2014-15**	**2015-16**	**2016-17**	**2017-18**	**2018-19**
Current Prices [$m]	2,963	2,858	2,858	2,936	2,788	2,832	2,333
Inflation Adjusted [$m]	3,079	2,929	2,949	3,044	2,788	2,783	2,276

The government is yet to substantiate the basis for the claim that the programme is ballooning beyond its control. Furthermore, given the object of the programme is to boost investment in R&D, it should be an expectation that the cost of the programme increase over time offset by an increase in GDP resulting from that investment.

The proposed changes to the refundable tax offset will couple the offset rate to 13.5% above the relevant corporate tax rate. When the R&DTI was introduced for income years from 1 July 2011 the R&D tax offset of 45% was specifically decoupled from the corporate tax rate so that companies had certainty around the benefit they could receive as a result of their spend on R&D activity. Although the offset rate has reduced, companies that qualify for the 27.5% corporate tax rate have been able to enjoy a 16% net tax benefit. The proposed changes will reduce the refundable offset to 41%, a four percentage point drop in the refundable offset available in the space of 7 years. If the corporate tax rate is reduced to that outlined in the Enterprise Tax Plan, claimants will be reduced to a refundable tax offset of just 38.5%.

It must also be noted that despite the reduction in offset rates, the turnover threshold of $20 million for those companies able to access the refundable offset has not changed since the Incentive was introduced. Yet in the 2019FY the threshold for companies being able to achieve the base rate for the 27.5% corporate tax rate is $50 million.

A base R&D tax offset of 4% for those companies with a turnover greater than $20 million under the changes would be the least attractive offering available by any R&D tax regime globally. At this level, the costs of compliance and administration for the R&DTI will dissuade many companies from accessing the scheme.

Given that a large number of companies accessing the non-refundable offset are multinational, the government is in effect incentivising these businesses to move or undertake key innovative developmental activities outside of Australia where the benefit may be greater. We are already aware

[2] Science, Research and Innovation (SRI) Budget Tables, 2018-19

of businesses considering relocation offshore should the new measures come into effect and of foreign businesses that have been discouraged from investing in R&D activities in Australia on the basis of the impending changes to the R&DTI regime.

As a result of the introduced measures, the government predicts it will derive $2.4 billion in savings over the next 4 years. However, it is important to note that these savings are not being redirected into other targeted innovation support programs, as was recommended in the 'The Review'.

Encouraging additionality

Whilst the R&D Intensity test is a key mechanism for reducing the cost of the R&D Tax Incentive programme, it is being held up on the pretext that the R&D Intensity Test will improve the operation of the programme by providing a greater level of 'Additionality', in terms of more R&D activity being undertaken, arising from the provision of the R&D Incentive tax foregone.

A purpose of this submission is to encourage the Committee to challenge the prevailing Government / Departmental interpretation of the concept of 'Additionality' which has been central to the rationale for the legislative changes the subject of this review. The immutable logic is that the Commonwealth provides a subsidy to encourage socially and economically beneficial research and development activity to be conducted and that the Government needs to better target the recipients of the subsidy so as to optimise the amount of additional research and development that takes place which would otherwise not take place.

The Review drew on academic literature based on marginal analysis of additional R&D conducted with delineation between ratios of additional activity for large versus small businesses thereby justifying the differential rates of assistance applying to small and large companies, which is the only real stratification of the assistance regime which otherwise applies universally to companies in Australia.

Our proposition in relation to the marginal additionality focus is that it is predicated upon a static, not dynamic view of economic activity and corporate decision making. It is predicated upon 'Australia centric' decision making. The R&D Tax Incentive is a subsidy that alters the after tax cost of conducting R&D activity in Australia. In today's increasingly globalised economy, the decisions made by company executives as to whether or not to conduct additional R&D activity in Australia will be dependent on a number of factors including the after tax cost of doing the activity in Australia versus conducting the same activity in other countries.

This concept of additionality has also manifest itself in some quite bizarre approaches to the interpretation of the R&D legislation with a push to exclude 'Business as Usual' activities notwithstanding whether companies are conducting socially and economically advantageous R&D on a 'business as usual' basis. The static outlook is also manifest in the 'business as usual' bogey that companies are receiving a subsidy for conducting activity that they would conduct irrespective of whether they received a tax benefit or not. In response, the proposed legislation will result in stratifying businesses by their 'R&D Intensity' and providing a variable rate of assistance to the detriment of the vast majority of large companies.

In our opinion, the focus on the amount of additional R&D activity arising from the Government revenue foregone and the attempt to 'target' the scheme to attempt to attain higher levels of 'additionality' is missing its mark. Not only will it be unnecessarily complex, it will be to the detriment of the vast majority of large companies conducting R&D. More importantly, it misses the bigger picture that Australia is increasingly having to compete with other countries as a location in which to conduct R&D activity and the after tax cost of the activity can be a crucial factor.

This is most obvious in relation to the R&D Intensity Test being applied to R&D activity being conducted by large companies. For large companies it more likely that there is flexibility as to where R&D activity is to be conducted. The bottom line is that Australia has to have a competitive taxation regime and this is particularly the case in relation to the R&D Tax regime, where, like Australia, there are specific incentive regimes provided by other countries to influence R&D location decisions.

The budget estimates factored in a reduced subsidy arising from the programme changes at over $600M per year. The vast majority of this reduced subsidy will arise from the reduction in the after tax benefit provided to large companies through the R&D Intensity Test. If Australia is going to achieve increased levels of business R&D expenditure, it will be large businesses that determine this outcome. The proposed measures act to the detriment of these companies and provide a confusing and reduced incentive for new large businesses to conduct R&D activity in Australia.

Recommendation

- The threshold for those accessing the refundable R&D Tax Offset should be raised to $50 million
- Redirect the $2.4 billion in savings from the new measures towards other programmes that support and reward Australian innovation

Improving transparency

As a means of increasing programme transparency, the proposed changes will incorporate the publishing of each company's R&D tax benefit and intensity in the public domain. Although these values will not be published until 2 years after the year in which the application is lodged, it may result in companies losing their competitive advantage.

The board of ISA will also be given additional powers to make determinations about the circumstances and ways in which it will exercise its powers, or perform its functions or duties, and may delegate their powers to any member of Australian Public Service staff assisting them. A cap of three months on the total extension available for registrations will also be introduced. Whilst these measures will offer greater integrity of the program, we believe that less disparity between industry and government can be achieved through providing early effective engagement training using real life examples of both activities that the programme intends to incentivise, and those that it does not.

There are also a number of examples of differences in interpretation of eligibility between industry and government, including computer modelling, routine testing, product development, and overhead allocation. Whilst the government retains internal guidance on their interpretation of the application of the legislation to these issues, little guidance has been provided to industry. In order to achieve true transparency, industry should have access or provide input to any such interpretations.

Recommendation

- The government should publish sanitised versions of all findings, rather than a public reporting of company claims

- Sector guidance materials should be developed in collaboration with industry stakeholders and use case studies based on sanitised real life examples and encompass both the eligibility of activities
- A conciliatory approach to resolving disparities in opinion, rather than a confrontational one.

Function of the R&D Tax Incentive

We wish to conclude our feedback with reference to the Object of the Research and Development provisions as set out in the Income Tax Assessment Act 1997:

Section 355-5 Object

(1) The object of this Division is to encourage industry to conduct research and development activities that might otherwise not be conducted because of uncertain return from the activities, in cases where the knowledge gained is likely to benefit the wider Australian economy.

(2) This object is to be achieved by providing a tax incentive for industry to conduct, in a scientific way, experimental activities for the purpose of generating new knowledge or information in either a general or applied form (including new knowledge in the form of new or **improved** materials, products, devices processes or services). [Emphasis added]

The object of the Act as set out above has been eroded over the course of time by amendments that not only limit the scope of what may constitute eligible activities or expenditure, but also by an uninformed and overzealous approach to the interpretation of the legislation and industry by the relevant regulators, AusIndustry and the Australian Taxation Office.

While it is accepted that amendments to the law can be made at any time, those amendments must be formulated having regard to the objects of the division being considered.

In approaching the object of the Act it is also incumbent on the Parliament to have due regard to The Acts Interpretation Act 1901 and the manner in which this Act has been applied by the Courts.

Construction of Acts subject to the Constitution

Every Act must be read and construed subject to the Constitution, and so as not to exceed the legislative power of the Commonwealth.[3] In some circumstances an Act may be read down or read as if it did not contain any invalid provisions, so that it may be given effect to the extent that it is not in excess of the power of the Commonwealth.[4]

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[3] Acts Interpretation Act 1901, s. 15A.

[4] see Bank of New South Wales v. Commonwealth (1948) 76 CLR 371.

Regard to purpose or object of Act

In interpreting a provision of an Act, an interpretation that would best achieve the purpose or object of the Act, whether expressly stated in the Act or not, is to be preferred.[5] The purpose of an Act may be stated in an objects clause, its long title and, if one exists, the preamble. A preamble does not have separate legislative effect, but may be used for clarification if the meaning of a section is unclear.

Over time, the Courts have adopted a number of methods to assist with the determination of the meaning of legislation. In particular, two approaches have been commonly adopted:

1. Literal rule – A fundamental rule of statutory interpretation requiring the interpretation of a statute according to the intention of Parliament, which is to be found by an examination of the language used in the statute as a whole and nothing more.
2. Purposive rule – An approach to statutory interpretation where a particular provision is interpreted ***in accordance with the purpose of the statute***. Traditionally, the purposive approach was applied only where the literal approach produced an ambiguity, inconsistency or absurdity. The purposive approach is adopted by looking at the words of the statute as a whole.

The purposive approach has been adopted more regularly by the Courts in respect of the interpretation of tax legislation, in particular those statutes or sections that have been enacted to provide a benefit or concession to the taxpayer. This should also be the case when enacting amendments to beneficial concessional legislation.

In support of the above contentions, we refer you to a paper prepared in 2011 by the Hon Michael Kirby, a retired judge from the High Court of Australia titled 'Statutory Interpretation: The Meaning of Meaning, which provided an insight into the High Court's approach to statutory interpretation. In that paper, Kirby makes the following observations:

In addition to the encouragement of a purposive interpretation, legislative provisions have been enacted to promote the interpretation of legislation in ways consistent with basic civil and human rights. In this respect too, Parliaments in Australia have followed a long line of common law authority favouring the expression of the law in a way that upholds traditional common law principles over one that would diminish basic rights.

During the past decade or so, the High Court of Australia has unanimously endorsed other principles as necessary to the accurate reading of legislation. Amongst the most important of these principles have been:

- that where the applicable law is expressed in legislation, the correct starting point for analysis is the text of the legislation and not judicial statements of the common law or even judicial elaborations of the statute;
- that the overall objective of statutory construction is to give effect to the purpose of Parliament as expressed in the text of the statutory provisions; and

[5] Acts Interpretation Act 1901, s. 15AA.

- that in deriving meaning from the text, so as to fulfil the purpose of Parliament, it is a mistake to consider statutory words in isolation. The proper approach demands the derivation of the meaning of words from the legislative context in which those words appear. Specifically, it requires the interpreter to examine at the very least the sentence, often the paragraph, and preferably the immediately surrounding provisions (if not a wider review of the entire statutory context) to identify the meaning of the words in the context in which they are used.

These and other explanations of the contemporary understanding of statutory interpretation have increasingly taken courts in Australia away from the previous 'literal', or so-called 'objective' or 'plain meaning', approach to interpretation. The notion that a word of the English language has a single, objective and scientific meaning that has only to be discovered has gradually given way to a more candid recognition of the choices that face those who interpret the written law and the way in which values and policy considerations can influence the making of those choices. That realisation presents the third element in contemporary statutory interpretation in Australia. Today, that task requires a combined exercise involving analysis of the *text*, *context* and *purpose* (or *policy*) of the statute in question.

It is with these words in mind that we believe it is incumbent on the Senate Committee to reconsider the approach being adopted by Treasury in seeking to limit the extent, value and benefit of the Research and Development Tax Incentive.

Purpose of the Bill

The purpose of the bill as suggested by its title and the explanatory memorandum of "Making Sure Multinationals Pay Their Fair Share" is misleading. A majority of the provisions contained with the bill, particularly those relating the R&DTI will have a limited impact on multinationals. Rather, the bill will have the greatest impact on Australia's SMEs.

Under the current provisions, taxpayers may claim a non-refundable tax offset for notional deductions up to a cap of $100 million, limiting the potential claim of multinationals. The bill proposes to increase this cap to $150 million, providing further tax relief to the large entities.

The taxpayers that are most likely to be impacted by the provisions are those that grow beyond the $20 million threshold during the next financial year. These taxpayers could see the support available under the R&DTI decrease by up to 75% as they move from a 16% after-tax benefit under the 43.5% refundable offset to just 4% under the proposed intensity test as part of the non-refundable tax offset.

This is one of a number of examples throughout the bill that demonstrate the disparity between the alleged purpose and function of the provisions. We therefore recommend the schedules of the omnibus bill are separated and considered by Parliament based on their individual merit.