Senate Standing Committee on Economics

ANSWERS TO QUESTIONS ON NOTICE

Treasury Portfolio

Budget Estimates

1 June – 3 June 2010

Question: BET 276

Topic: Recommendation away from tax concessions for research and development

Hansard Page: Written

Senator Eggleston asked:

Can you explain the justification behind the recommendation away from tax concessions for research and development? Can the Commission provide the modelling behind that plan?

Answer:

The Commission has not undertaken recent research on the R&D Tax Concession, which the Government proposes should move to a tax credit basis following the Cutler review. In its 2007 commissioned research report on *Public Support for Science and Innovation*, the Commission made several findings in respect of reforming the R&D Tax Concession (pp. 381ff). These were:

- There should be a tightening of the definition so that only genuinely novel R&D was eligible for concessional tax treatment.
- The evidence from empirical analysis of the extent to which tax concessions induce *new* R&D (rather than supporting R&D that was going to happen anyway) suggested that the base R&D tax concession (at 125% at the time) would stimulate little new R&D, especially for large firms. As a result, the Commission found the 125% concession should be limited to small firms, while the 175% incremental component should be preserved for all firms, though with some changes to its detailed implementation.
- Businesses domiciled abroad should become eligible for the incremental component of the tax concession, given the importance of technological spillovers from these firms. (Spillovers are ideas that spread across industry without any payment for them – for example, the idea of a mobile phone is not patentable, even if a particular technology that gives effect to it is.)
- There are grounds for changes to tax offset arrangements to address some of the perverse incentives against undertaking R&D associated with its thresholds.

These findings are relevant to any form of tax concession, whether deductions against corporate income or tax credits. The proposed new tax credit arrangements are at least partly consistent with these findings, in that it is proposed that:

- eligibility rules should be tightened
- overseas domiciled firms should receive some R&D tax credits

- a tax credit be used, which at least for small loss-making firms is equivalent to a simplified tax offset system
- large and small firms receive different levels of assistance.

However, the Commission has not analysed the implications of the higher level of assistance given under the new arrangements, the arguments for a tax credit compared with the current deductions-based approach, or any of the details of the proposed new arrangements.