Summary and Recommendations

Research and development (R&D) by businesses can lead to innovations which boost productivity, an important contributor to economic growth. The Committee notes that Australia's R&D performance, allowing for its industrial structure, is comparable to its peers. It believes that there is potential for the economy to grow faster if businesses undertook R&D which provides value for taxpayer support and stimulates growth in value adding activities. It therefore understands why successive Australian governments have operated schemes to use tax concessions, among other measures, to encourage firms to undertake R&D.

The current scheme, however, does not make the best use of the money which taxpayers are foregoing. This bill seeks to reprioritise this support. An effective scheme will focus on generating *additional* R&D which brings broader benefits which *spill over* to other companies, rather than merely benefiting the company undertaking it. This is more likely to occur when the support goes more to small to medium, newer, more innovative companies undertaking genuine R&D. Too much support under the current scheme is going to large established firms undertaking routine spending only tangentially related to research and benefiting only themselves. It is unsurprising that such firms, and their advisers, may oppose the bill, but the mere fact that big companies currently receive support is not in itself a justification for their continuing to receive it. It is neither sustainable nor in the national interest that 60 per cent of the total government support for business R&D is consumed by 100 firms out of Australia's two million enterprises.[1]

The design of the new R&D assistance has been informed by a number of detailed inquiries with broad consultation with industry, unions and consultants, both before and since the release of the exposure draft.

A significant change welcomed by the Committee is allowing companies with turnover less than $20 million to receive a tax credit, rather than having to wait until they are profitable to benefit from the tax concession. This recognises that many new innovative companies may take some years to become profitable and it is precisely during this period that support is most beneficial. The Committee is also pleased that the level of support for smaller companies increases to the equivalent of a 150 per cent deduction (from the present 125 per cent), doubling the after-tax value of the support. The removal of the complex 175 per cent incremental premium, which perversely rewards volatile R&D and is of no assistance to new firms, is also a step forward.

A change in the bill that attracted wide support is removal of the requirement that intellectual property be owned in Australia. Similarly the changes to the exclusions surrounding 'in house' software have been generally applauded.

1 Senator the Hon Kim Carr, Minister for Innovation, Industry, Science and Research, *Senate Economics Committee Hansard*, 31 May 2010, p. 51.

While the intent of the bill is to ensure that access to R&D support is timely and targeted, the Committee is concerned that there appears to be a mistaken view that the bill proposes to restrict support solely to (basic) research. In particular, the proposition was advanced that requiring supporting expenditure to have a 'dominant purpose' of supporting core R&D was excessively restrictive. The opportunity should be taken to ensure the intent of the law is clear prior to its enactment and a process is in place to monitor and review issues as they arise.

Recommendation 1

The Committee recommends that subsection 355-5(2) of the objects clause be amended to clarify the reference to 'new knowledge or information in either a general or applied form' by adding 'new knowledge in an applied form includes new or improved materials, products, devices, processes or services'.

Recommendation 2

The Committee notes that many of the concerns were raised by organisations who want to maintain the status quo. Nevertheless, given the concerns raised, but acknowledging the need to ensure that public support is targeted appropriately, the Committee recommends that the definition of 'core R&D activities' in section 355-25 be amended to remove the word 'about' from paragraph 355-25(1)(b) so that the paragraph reads as:

> **[talking about experimental activities] that are conducted for the purpose of generating new knowledge (including ~~about~~ the creation of new or improved materials, products, devices, processes or services).**

Recommendation 3

Given the scope of the changes proposed, the Committee is of the view that the amended provisions, including the effect of the 'dominant purpose' test, be reviewed after two years to ensure that the legislation is operating consistently with the Government's intent.

The Committee supports the goal of reducing complexity which is an impediment to small business benefiting from the assistance. It commends the many areas where the bill has simplified matters. The Committee notes some concerns about the complexity of the feedstock provisions and the dominant purpose test but does not believe these will be a problem for large companies. The Committee recommends that some of the additional $38 million in funding being provided to the Australian Taxation Office and the Department of Innovation, Industry, Science and Research is used to help small businesses comply with the provisions.

Recommendation 4

The Committee recommends that companies with revenues under $20 million be exempt from the dominant purpose test.

Recommendation 5

The Committee recommends that a broad–based working group including small business and union representatives be established to advise Innovation Australia and the Department of Innovation, Industry, Science and Research about any unforeseen circumstances that emerge as the bill is implemented. This working group would also inform the two year review of the bill (Recommendation 7).

The Committee notes concerns about the capacity of Innovation Australia to assess eligibility claims. Having considered the evidence presented, the Committee takes the view that they have the expertise and the requisite knowledge and skills to make decisions. The general guidance material and public findings to be provided should mitigate the compliance concerns raised by some submitters.

The Committee's attention was drawn to claimed drafting errors.

Recommendation 6

The Committee notes the claim of drafting errors. The Committee notes that minor drafting errors are common when framing new legislation. The Committee does not believe that these minor errors are of sufficient magnitude to delay passage of the bill but considers it preferable that they be dealt with before the bill is enacted.

The Committee expects the bill will increase the amount of R&D by small firms and in time this should lead to stronger economic growth. Firms continuing to receive assistance will be paid at a higher rate. On the other hand, the 175 per cent premium concession is being abolished and eligibility rules tightened. The Committee accepts Treasury's modelling that the net impact will be about revenue-neutral, although it is hard to be precise. Given these uncertainties the operation of the bill should be reviewed after it has been operating for some time.

There have been calls for the Senate to delay considering the bill and defer its operation for a year. The Committee takes the view that many of these calls are more an expression of opposition to the Government's policy objective of targeting R&D assistance more towards small and medium enterprises and spreading the benefits more effectively across industry. This opposition is unlikely to disappear as a result of further discussion. The Committee believes its recommendations address the misapprehensions that have led to some calls for delay.

Recommendation 7

The Committee recommends that the Senate pass the bill, with the amendments proposed in the earlier recommendations, before the end of June 2010. The operation of the bill should be monitored on an ongoing basis and reviewed after two years.