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Ms Roberta Bausch
Science and Innovation Study
Productivity Commission
PO Box 80
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22 December 2006

Dear Ms Bausch

PricewaterhouseCoopers response to draft findings of the Productivity Commission 2006, *Public Support for Science and Innovation*, Draft Research Report, Productivity Commission, Canberra.

We refer to the Productivity Commission's draft findings in respect of the R&D tax concession, specifically, draft finding 9.1 which states:

"*The R&D tax concession could be improved by:*
- *shifting the orientation of the concession towards its 175 per cent incremental component;*
- *relaxing the beneficial ownership requirement and the expenditure and turnover thresholds for the tax offset for the incremental scheme alone;*
- *changing the base on which the incremental subsidy is paid to a firm's ratio of R&D to sales at a given, fixed date; and*
- *allowing access to the incremental scheme to start-up firms.*"

Shifting the orientation of the concession towards its 175 per cent incremental component

We believe that shifting the orientation of the R&D tax concession towards its 175% incremental component will not provide an incentive for businesses to increase their R&D intensity either immediately or in the long term.

PricewaterhouseCoopers recently conducted surveys of 44 companies from around Australia about their current views on selected parts of the R&D tax concession and how it impacted their businesses. When asked the question "*Would narrowing the tax concession to only additional incremental expenditure encourage greater investment in R&D by your company?*" (answer limited to Yes, No and Unsure) the emphatic response from 39 of the respondent was a 'No" and five were "unsure".

The Draft Research Report states that the "..*purpose of public support should not be to subsidise activity that would have occurred anyway. This is much less likely to be an issue under an incremental scheme.*" This statement appears to fly in the face of stated policy intent of the R&D tax concession since its inception.

Since the R&D tax concession's introduction in 1986, the number of companies accessing the R&D tax concession has steadily increased from less than 2,000 in 86/87 up to the most recent data for the year ended 30 June 2005 which states that 5,961 companies accessed the R&D tax concession (*R&D Tax Concession Administration Consultative Group Meeting November 2006* – attached Appendix A). The only period during which R&D registration by companies fell, with a commensurate drop in R&D spend, was following the reduction in the R&D concessional rate from 150% to 125% in 1996. Whilst some of this drop may be attributed to the removal of R&D syndicates, it provides a clear indication that companies will spend more on R&D if the incentive to do so is present.

The removal of the benefit for the majority of companies through a targeted support for 175% incremental deductions would only support 1 in 5 companies who presently access either the R&D tax concession or R&D tax offset (statistics based on year ended 30 June 2005 data – see appendix A). Further, the lack of a 125% incentive may significantly reduce the total number of companies performing R&D given the 175% incentive may prove to be unquantifiable due to the significant complexity of the legislative calculations. Without a quantifiable R&D incentive, many companies may choose to either move R&D functions overseas or just not bother registering an R&D claim ie. the documentary requirements for registration may be seen to be onerous given the lack of potential benefits. In our opinion, this lack of certainty would not drive companies to deliver the kinds of benefits that a "smart" economy should be aiming to achieve.

Changing the base on which the incremental subsidy is paid to a firm's ratio of R&D to sales at a given, fixed date

The incremental 175% R&D tax concession is already an extremely complex piece of legislation. Adding further complexity to the legislation by overlaying a R&D-to-sales ratio would only further confuse companies wanting to access this benefit.

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From our extensive experience of consulting to companies on the R&D tax concession, the incremental 175% tax concession is the least well understood part. The potential overlay of a fixed base R&D-to-sales ratio would only, in our opinion, *decrease* the attractiveness of the 175% incremental scheme outlined in the Draft Research Report as the added complexity would only be compounded the introduction of such a system.

As an alternative, we believe that it would be prudent to firstly make modifications to streamline the current 175% legislative provisions first before adding another layer of complexity. In our opinion, the streamlining of such provisions may result in an increase in the current number of 175% claimants as the current complexity of the legislation may be adversely impacting upon companies performing R&D. PricewaterhouseCoopers would be pleased to assist in providing further recommendations in this regard if requested.

Allowing access to the incremental scheme to start-up firms

The introduction of an incremental scheme for start-ups without any changes to the $5M turnover and $1M R&D spend thresholds will, in our opinion, be of limited use to start-up businesses whose primary focus is R&D.

In our experience, further attention should be focused on allowing businesses who meet the $5M turnover threshold but fail the $1M R&D threshold to cash out their R&D spend up to the $1M mark and then access either the 125% or 175% concessional deductions for the remainder of their eligible R&D spend. This would provide the greatest advantage to these start-up businesses in our opinion.

Yours sincerely

A Baxter

Tony Baxter
Partner
Tax and Legal Services