

AUSTRALIAN
ADVANCED
MANUFACTURING
COUNCIL

**Submission
to the Federal Government
Tax Review 2015**



May 29 2015

Summary of recommendations

1. Encourage industry-research collaboration through tax reform

Recommendation:

In order to effect a step change in collaboration between business and publicly funded researchers, double the R & D tax incentive for R & D that is done in collaboration with an approved Australian Research Institute or university.

2. Support mechanisms that encourage more R & D

Recommendation:

Immediately remove the \$100 million cap on the R & D expenditures that companies can claim as tax deductions, and immediately withdraw proposals to reduce R & D tax offsets.

3. Stem the loss of Australian innovation and IP overseas

Recommendation:

Introduce an Innovation incentive scheme to attract and maintain high value manufacturing in Australia.

This innovation incentive would effectively provide a reduced corporate tax rate on incremental income from qualifying activities. Applicants would be required to submit plans for substantive commitments in manufacturing or for expanding knowledge-rich activities or capabilities in Australia.

4. Encourage investment in new plant and equipment

Recommendation:

Expand the application of Federal Government rules of accelerated depreciation. Give a taxpayer the option of claiming accelerated allowances as an alternative form of tax depreciation, as follows:

1. Allow all plant and machinery, except motorcycles, cars and light goods vehicles (weighing 3 tons or less), to be written off at 33.3 per cent over three years.

2. Grant a 100 per cent accelerated depreciation allowance in the first year for capital expenditure incurred on the following:

- the purchase of selected new machines, equipment or systems that demonstrably improve productivity and efficiency than similar ones currently used*
- the installation of engineering control measures for existing machines, equipment or processes, with the primary objective to improve productivity and efficiency*
- the purchase of selected new equipment or systems that do not pose a significant chemical or environmental risk*
- the installation of engineering control measures for existing machines, equipment or processes to minimise chemical and environmental risk*
- certified energy saving or energy efficient equipment*
- efficient pollution control equipment or device*
- computers, robots, computer-aided machines and most other electronic equipment*

Caps to be determined through consultation with industry. Current anti-avoidance provisions within the Act are considered adequate.

5. Follow international accounting practice for IP tax treatment

Recommendation:

Recognise Intellectual Property as a depreciable asset, whether it is developed internally or acquired. Include goodwill and trademarks in these definitions. Adopt international accounting practice and allow IP amortisation expenses for tax purposes.

Overview

Advanced Manufacturing

We define “Advanced Manufacturing” as globally-oriented and innovative manufacturing.

Advanced manufacturers are those who:

- leverage the latest thinking in technology and materials;
- produce for the global market / global supply chains;
- tend to be engaged in collaborations with universities, CSIRO and other research institutes, and:
- tend to have smaller capital and labour footprints but are often higher paying, and provide higher quality work. They employ a higher concentration of scientists and engineers.

Globalisation

Taxation reform must take into account globalisation, trade liberalisation and highly competitive global supply chains.

These factors have imposed new business models in which innovation, design, brands, trademarks, patents and other forms of intellectual property, as well as goodwill, are fundamental business assets and drivers of global value.

Global competition for these highly portable assets is robust.¹

For example, several countries in our region are expanding their R & D incentive schemes, namely, Japan, New Zealand, Singapore and South Korea. Australia's tax regime is comparatively unattractive for maintaining and encouraging new investments in knowledge-rich industries.²

¹ Singapore, for example, has introduced a range of generous incentives, including financial grants and tax incentives, covering various activities along the productivity and innovation value chain. Among these:

- 150 per cent to 400 percent tax deduction for expenditure qualifying R&D activities
- 400 per cent tax deduction for qualifying expenditure pertaining to the registration of IP rights
- 400 per cent tax allowance for qualifying costs of acquiring and in-licensing of IP rights.

² KPMG Asia Pacific (ASPAC) R&D Incentives Guide 2014, edition 5. See Comparative Table on page 7.

Growing Small Business

Encourage industry-research collaboration through tax reform

We have a rich seam of successful advanced manufacturers in Australia. These companies are not only securing their own future, but helping to underpin a sustainable Australian economy.

The world is moving fast adopting new technologies and manufacturing processes, and creating new industries.

AAMC applauds work being undertaken to improve SME capabilities and industry-research collaboration nationally. Public-private partnerships between globally-focused small, medium and large advanced manufacturers and Australia's leading research institutions will be critical to improving Australia's economic future. In line with this, we strongly support the Government's Industry Innovation and Competitiveness Agenda and the development of five Industry Growth Centres.

Australia's predominantly small and medium sized enterprises (SME), however, face challenges in stepping up to the requirements of global business.

The key driver of both growth AND productivity in the manufacturing sector is innovation. Policies must provide strong impetus for business R&D, particularly collaborative R&D, to bring the best of the national innovation system together to address productivity challenges.

We need to improve Australian research and innovation impact across the board, particularly with the SME sector. Current measures for collaboration are not driving the right behaviors and outcomes. As such, the AAMC recommends the following tax reform.

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Recommendation:

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R & D and innovation incentives

Support mechanisms that encourage more R & D

Australian businesses that aspire to create high value products and processes will inevitably engage in substantial R & D to maintain their global competitiveness.

The Research & Development tax incentive is critical for driving innovation in advanced manufacturing.

Empirical research indicates that countries that invest significantly in R & D see better economic outcomes, particularly among SMEs.³

Compared to other advanced countries, Germany and the United States, for example, Australia falls well behind in terms of its expenditure in R & D. According to the OECD, Australia spent approximately 0.227 per cent of GDP on research and development in manufacturing in 2011, compared to 1.29 per cent in the United States and 1.33 per cent in Germany.⁴

Investment in R&D results in tangible economic outcomes, driving product and process innovation in the economy and spawning new industries. In high-wage, high-technology economies, R&D investment is 'a prominent driver of technological innovation and economic growth'.⁵

In light of this, the recent decision to place a \$100 million cap on the R & D expenditures that companies can claim as tax deductions – coupled with suggestions that further cuts are imminent – must be regarded as a significant backward step.

This has enormous ramifications for future investment by multinationals (MNC), including our own MNCs, in R & D hub activity in Australia.

At the same time, the current Tax and Superannuation Amendment (2015 Measure No.3) Bill 2015 before Parliament proposes reducing the refundable tax offset from 45 to 43.5 per cent (equivalent to a 10 per cent reduction in the permanent benefit to small companies) and the non-refundable tax offset from 40 to 38.5 per cent (equivalent to a 15

³ Office of the Chief Scientist 2014, *Science, Technology, Engineering and Mathematics: Australia's Future*. Australian Government, Canberra; The Brookings Institution, America's Advanced Industries, "What They Are, Where They Are and Why They Matter", February 2015; among others.

⁴ OECD – statistics. Dataset: Business enterprise R-D expenditure - manufacturing (ISIC 4) - constant prices & PPPs

⁵ The Brookings Institution, p. 19.

per cent reduction in the permanent benefit to large companies).

This latest measure is potentially more destructive to innovative companies than the original proposal (2014 Measure No. 5). Under the first proposal, the permanent tax benefit would have been restored by a 1.5 percentage point reduction in the corporate tax rate 12 months later. However the Federal Budget 2015 proposes to reduce the corporate tax rate for small companies (<\$2 million turnover) only.

Australian Governments provide a comparatively low level of Research & Development support to business in the form of tax credits. The OECD Science, Technology and Industry Scoreboard 2010 placed Australia towards the bottom range of countries in direct and indirect government support for R & D. (See Appendix 1)

2. Support mechanisms that encourage more R & D

Recommendation:

Immediately remove the \$100 million cap on the R & D expenditures that companies can claim as tax deductions, and immediately withdraw proposals to reduce R & D tax offsets.

Stem the loss of Australian innovation and IP overseas

Research and development activities that otherwise might have been located in Australia – and the manufacturing and consequent employment and wealth creation that is associated with this – are being lost to other advanced economies.

CSL is Australia's largest biotech company and a global leader in plasma-derived therapies and their recombinant analogues, and a leading developer of antibodies. The company recently conducted an international search to manufacture – on a global-scale – a novel recombinant coagulation product developed in Australia. Australia was found to be uncompetitive and did not win the project.

This is just one example on the public record.⁶

Based on the evidence of activity shifting out of Australia, it must be argued that other advanced countries are attributing a higher value to knowledge industries (including those developed in Australia) than Australia. The opportunity cost is significant – and growing.

⁶ CSL submission to the Senate Inquiry on Australia's Innovation System. 31 July 2014.

The rush of countries taking up the idea of a “Patent Box” suggests this may lead to a redistribution of IP rather than the creation of new IP. The challenge is to design a system that confines the concessional corporate tax rates to genuinely new investment that is based on intellectual property that has been substantially developed and remains owned in Australia.

An **innovation rebate scheme** may offer an alternative to preferential tax treatment or substantial changes to Australia's corporate tax rate.

However such a scheme is constructed, **an innovation incentive** is vital.⁷

The AAMC strongly supports an incentive similar to Singapore's Development and Expansion Incentive, which would effectively provide a reduced corporate tax rate on incremental income from qualifying activities.

Applicants would be required to submit plans for new substantive commitments in manufacturing or for expanding knowledge-rich activities or capabilities in Australia.

Over the past 15 years, the Singapore Government has consistently focused policy attention on a “Future Ready Singapore”, extending the country's value proposition to businesses. The results include increasing numbers of global multinationals establishing large R & D functions in the country, with significant benefits for local advanced manufacturing industries.

3. Stem the loss of Australian innovation and IP overseas

Recommendation:

Introduce an Innovation incentive scheme to attract and maintain high value manufacturing in Australia.

This innovation incentive would effectively provide a reduced corporate tax rate on incremental income from qualifying activities. Applicants would be required to submit plans for substantive commitments in manufacturing or for expanding knowledge-rich activities or capabilities in Australia.

⁷ The Australian Innovation and Manufacturing (AIM) Incentive proposal, developed by a collaboration of Australian industry bodies and companies, proposes a 10 per cent tax on qualifying income.

Depreciation

Encourage investment in new plant and equipment

Accelerated depreciation refers to one of several methods by which a company, for financial accounting and/or tax purposes, depreciates a fixed tangible asset in such a way that the amount of depreciation is higher during the earlier years of an asset's life.

For tax purposes, accelerated depreciation provides a way of deferring corporate income taxes by reducing taxable income in current years in exchange for increased taxable income in future years.

This is a valuable tax incentive that encourages the purchase of and investment in new assets.

Currently, rules related to accelerated depreciation have limited application, and should be expanded to encourage all Australian manufacturers to invest in new plant and equipment, and adopt more efficient processes.

4. Encourage investment in new plant and equipment

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Expand the application of Federal Government rules of accelerated depreciation. Give a taxpayer the option of claiming accelerated allowances as an alternative form of tax depreciation, as follows:

1. Allow all plant and machinery, except motorcycles, cars and light goods vehicles (weighing 3 tons or less), to be written off at 33.3% over three years.

2. Grant a 100% accelerated depreciation allowance in the first year for capital expenditure incurred on the following:

- the purchase of selected new machines, equipment or systems that demonstrably improve productivity and efficiency than similar ones currently used*
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- the purchase of selected new equipment or systems that do not pose a significant chemical or environmental risk*
- the installation of engineering control measures for existing machines, equipment or processes to minimise chemical and environmental risk*
- certified energy saving or energy efficient equipment*

- *efficient pollution control equipment or device*
- *computers, robots, computer-aided machines and most other electronic equipment*

Caps to be determined through consultation with industry. Current anti-avoidance provisions within the Act are considered adequate.

Intellectual Property tax treatment

Follow international accounting practice for IP tax treatment

Intellectual Property (IP) lies at the heart of value-add and advanced manufacturing profitability.

The tax regime in Australia must be designed to attract and encourage advanced industries, rather than acting as a disincentive for the maintenance of these industries. In our estimation, a significant amount of revenue is lost through location of IP offshore – IP investments which could be located here.

The moment we accept that IP ownership and licensing control of our best research efforts is expendable, we lose the most valuable aspect of our creations. We lose jobs and expanded business opportunities for suppliers. We also create the perfect conditions for tax leakage.

In contrast to a majority of OECD countries, Australia's tax treatment of IP does not reflect a 21st Century understanding of industry and global imperatives.

Most OECD jurisdictions follow international accounting practice for IP tax treatment and allow depreciation of IP, including goodwill and trademarks, as a tax deduction. Australia does not.

Tax treatment that fully recognises the competitive importance of intellectual property is vital, and an important step toward removing the incentives for so-called "profit shifting".

The fact that tax depreciation is not available in respect of acquired trademarks and goodwill contributes to a view that Australia is typically not considered a favorable jurisdiction to locate the IP assets of multinational corporations.

An internationally competitive tax depreciation regime would encourage investment in and reallocation of intellectual property in Australia and enable innovative companies to invest further in IP creation and more effectively protect themselves from private label piracy of IP.

5. Follow international accounting practice for IP tax treatment

Recommendation:

Recognise Intellectual Property as a depreciable asset, whether it is developed internally or acquired. Include goodwill and trademarks in these definitions. Adopt international accounting practice and allow IP amortisation expenses for tax purposes.

About the Australian Advanced Manufacturing Council

The *Australian Advanced Manufacturing Council* is a CEO-led private sector initiative pursuing Australian success in advanced manufacturing. The AAMC brings together industry leadership to drive innovation success and resilience in the Australian economy.

AAMC Members represent the creative and driving energy behind successful transformations of Australian brands and companies, large and small, as well as global multinationals with a strong interest in Australia's future.

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Appendix 1

Direct government funding of business R&D and tax incentives for R&D, 2010 - as a percentage of GDP

Source: OECD, Main Science and Technology Indicators (MSTI) Database, June 2012; OECD R&D tax incentives questionnaires, January 2010 and July 2011; and national sources, based on OECD (2011), OECD Science, Technology and Industry Scoreboard 2011, OECD, Paris.

