AUSTRALIAN
ADVANCED
MANUFACTURING
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SUBMISSION TO THE FEDERAL BUDGET 2016

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Contents

Overview

Global competition is intensifying

The Australian Advanced Manufacturing Council's (AAMC) study of Australia's competitiveness in terms of innovation tax incentives, *How Australia Compares*, found Australia lagging in 10th place out of 12 comparable nations studied.[1]

Global competition for highly portable Intellectual Property (IP) assets is robust.

In 2013, the United Kingdom introduced the so-called "Patent Box" which enables companies to apply a lower corporate tax rate – 10% - to profits earned after 1 April 2013 from its patented inventions. [2]

Switzerland is proposing a License Box incentive to provide reduced rates of tax on IP-related profits. Ireland, Singapore and Canada are among other nations either in the process of introducing similar incentives or that have already reduced overall corporate taxes to attract foreign investment in advanced manufacturing. [3]

Advanced manufacturing powering innovation

Australia's advanced manufacturers are the engine room of our innovation economy.

Advanced manufacturers do not fit neatly into a single sector: they work in food processing and agribusiness, in mining equipment and technology, in a range of engineering applications, in precision instruments, in cyber technologies, in defence, aerospace and transport, in medical devices, in blood plasma therapies, in advanced materials and chemicals.

These companies leverage the latest thinking in technology and materials. They produce for a global market. And they are more likely to hold a higher proportion of intangible or knowledge-based assets.

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1 *How Australia Compares*: AAMC study of Australia's innovation tax competitiveness, 4 December 2015.

2 Ibid, pp 27-28

Following recommendations made by the OECD as a result of its review of harmful international tax practices, the rules relating to Patent Box qualification will be tightened from 1 June 2016: from that date,
– IP entering the Patent Box regime must have been developed (or partially developed) in the UK.
– IP qualifying before that date will continue to enjoy the benefit of Patent Box until 2021, when it will be reassessed according to the new R&D requirement.

3 Ibid, pp 14-29

Taxation and government policy reform - to enable these companies to flourish and thus Australia to capture value - must take into account the imperatives of 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.

Australian manufacturers face technology and capability challenges

Right now, significant technological shifts are occurring in manufacturing.

The commercial applications for artificial intelligence and machine learning are expanding; we see robotics entering a new phase; significant advances are occurring in nanotechnology, 3D printing, genetics, biotechnology, chemistry and materials science.

Developments in cyber-physical systems suggest a new world of both danger and opportunity for our advanced manufacturing businesses.

Companies must keep pace to remain globally competitive. This requires accelerating the uptake and development of technology and processes across industry.

The following recommendations are focused on government interventions that can help grow business capabilities in Australia, and enable Australia to capture value in a highly competitive global economy.

We commend this submission to you.

Growing Small Business

1. Redirect Automotive money to Growth Centres

The Automotive Transformation Scheme (ATS) was given a budget in 2009 of up to $2.5 billion over 10 years. The ATS was aimed broadly at encouraging competitiveness and innovation in the Australian automotive industry.

With the subsequent decision by all three major foreign-owned carmakers to exit Australia in 2016 and 2017, it is clear there will be unspent monies.

The Federal Budget 2015-16 allocated $226 million to the Scheme for the current year, and announced further forward estimates of $166 million in 2016-17 and $63 million in 2017-18.[4]

The Government, at the same time, has invested in the development of a number of Industry Growth Centres. The express purpose of these Centres is to drive innovation, productivity and competitiveness in Australian industry.

We believe the Growth Centres are critically important "machines" designed to drive the growth of our future economy.

While it is understood the ATS is an annual appropriation - in other words, subject to future year Budget decisions - we would urge this money continue to be invested in building industry competitiveness. We specifically recommend these allocations be redirected to the Industry Growth Centre program.

The Growth Centre machines are already built; they just lack petrol. Sufficient funding will help guarantee their success.

RECOMMENDATION:

Redirect the ATS allocation to the Industry Growth Centre program.

[4] http://industry.gov.au/AboutUs/Budget/Documents/PBS-2015-16.pdf

2. Revise the definition of small business

The current Australian Taxation Office (ATO) definition of small business is: an individual, partnership, trust or company with aggregated turnover less than $2 million.

By contrast, in the European Union, a small business is one with less than 50 employees and also an annual turnover of below 10 million Euros; in the US, a small business employs up to 500 employees.

While small businesses play a significant role in the Australian economy, they also face a unique set of operational challenges, and as a consequence typically have higher failure rates than those for larger businesses and companies.[5]

Revising the definition to better reflect the reality of viability for a small business will help promote a stronger economy; it will ensure these entities gain full and reasonable benefit from ATO allowances for small business, and support their growth and continued viability into the future.

RECOMMENDATION:

Revise the definition of "small business" from current $2 million revenue or less per year to $20 million, to better reflect the reality and allow Australian small businesses to operate on a more level playing field vis-à-vis their overseas competitors.

[5] ABS (March 2015) reports: Of the 294,210 new business entries during the 2010-11 financial year:

- 76 per cent were still operating in June 2012
- 59 per cent were still operating in June 2013
- 50 per cent were still operating in June 2014.

http://www.abs.gov.au/ausstats/abs@.nsf/mediareleasesbytitle/950EC94DB899312ECA2573B00017B8F4?OpenDocument

Fostering industry capabilities

3. Accelerate depreciation on 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.

RECOMMENDATIONS:

Expand the application of Federal Government rules of accelerated depreciation.

Give taxpayers 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*
- *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.

4. Follow international accounting practice for amortisation of intangibles

Amortisation of intangible assets is not always tax deductible. Its deductibility depends on the corporate income tax legislation of individual countries.

The AAMC welcomes the Australian Government decision in the *National Innovation and Science Agenda* (NISA) to provide businesses with a new option to self assess the tax effective life of acquired intangible assets that are currently fixed by statute. [6] This will better align tax treatment of the asset with the actual number of years the asset provides an economic benefit.

This means that the same tax treatment will be available for these intangible assets as is available for other types of assets. As the NISA documents state: "This faster depreciation will make startups' intellectual property, as well as other intangible assets, a more attractive investment option."

Australia differs from most OECD countries

The above reflects both the increasing importance of such assets commercially and their acknowledged volatility in value.

Australia's tax treatment of trademarks and goodwill, however, is not consistent with its treatment of other intangibles.

Most OECD countries follow international accounting practice and allow tax amortisation benefits for goodwill and trademarks, along with other intellectual property (IP) such as patents, copyright and software. Australia allows only the latter. Exclusions of this kind continue to add to a view that Australia is less interested in high value investments.

In one recent analysis, of a group of 15 OECD countries (See Table 1 below), Australia is the only one that does not allow tax amortisation benefits for trademarks - and one of only three (France, New Zealand are the other two), who do not allow tax amortisation benefits on goodwill.

RECOMMENDATION:
Recognise all forms of IP as depreciable assets. Include goodwill and trademarks in these definitions. Adopt international accounting practice and allow IP amortisation expenses for tax purposes.

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[6] http://www.innovation.gov.au/factsheets/intangible-asset-depreciation: the *National Innovation and Science Agenda*, December 7, 2015.

TABLE 1: Comparison of Tax Amortisation Benefits by Country

OECD Member	Tax Amortisation Benefit (TAB) on Trademarks (TM)	TAB for Goodwill	Country	Patents	Technology	Trademark	Customer relationships	Goodwill
✓	X	X	Australia	20	4	no TAB	no TAB	no TAB
✓	✓	✓	Austria	RUL	RUL	15	RUL	no TAB
✓	✓	✓	Canada	14.3 (75% only)	14.3 (75% only)	14.3 (75% only)	14.3 (75% only)	14.3 (75% only)
X	✓	✓	China	10	10	10	10	no TAB
✓	✓	X	France	5	5	no TAB	no TAB	no TAB
✓	✓	✓	Germany	RUL	RUL	RUL	RUL	15
X	✓	X	Hong Kong	1	1	5	no TAB	no TAB
X	✓	✓	India	4	4	4	4	4
✓	✓	✓	Ireland	15 or RUL	15 or RUL	15 or RUL	15 or RUL	15
✓	✓	✓	Italy	2	2	18	18	18
✓	✓	✓	Japan	8	5-Mar	10	5	5
X	✓	X	Malaysia	5	2.5	5	no TAB	no TAB
✓	✓	✓	Mexico	6.7	6.7	20	6.7	no TAB
✓	✓	✓	Netherlands	RUL (5-20)	RUL (5-20)	RUL (5-20)	RUL (5-20)	10
✓	✓	X	New Zealand	RUL	RUL	RUL	no TAB	no TAB
✓	✓	✓	Poland	RUL	RUL	RUL	RUL	5
X	✓	✓	Russia	RUL or ≥2	RUL or ≥2	RUL or 10	RUL or 10	5
X	X	X	South Africa	20	no TAB	no TAB	no TAB	no TAB
✓	✓	✓	Spain	RUL	RUL	20 or RUL	RUL	20
✓	✓	✓	United Kingdom	25 or RUL	25 or RUL	25 or RUL	25 or RUL	no TAB
✓	✓	✓	United States of America	15	N/A	15	15	15

RUL – Remaining Useful Lifetime; TAB – Tax Amortisation Benefit

Encouraging "beyond the usual" R&D

5. Government procurement can help small business R&D

We can learn a lot in Australia from one of the most successful schemes in government-industry cooperation worldwide.

The Small Business Innovation Research (SBIR) Scheme has been running successfully in the United States for 40 years.

The Australian Government recently gave welcome encouragement to the notion of "Government as Exemplar" on innovation. [7] Government procurement was targeted, and $19 million allocated to a "Business Research and Innovation Initiative" expected to launch on 1 July 2016. [8]

While the concept is borrowed from SBIR, its structure would appear to miss elements that form the backbone of the US program.

As the *National Innovation and Science Agenda* (NISA) notes, the Australian Government spends about $50 billion on procurement annually but ranks just 70th out of 140 countries on how well its procurement fosters innovation.

The Academy of Technological Sciences and Engineering (ATSE) has often pointed out that the lack of an SBIR-like scheme is a gaping hole in the Australian innovation ecosystem.

Mandating a percentage of procurement spend to small business

The SBIR supports and endorses scientific excellence and technological innovation through the simple but effective investment of Federal research funds into critical research and development (R&D) areas.[9]

Participating government agencies are required to allocate 2.8% of their R&D budget into SBIR programs, in which any small business can bid to undertake the projects.

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[7] *National Innovation and Science Agenda* (NISA), December 7, 2015: http://www.innovation.gov.au/theme/leading-example

[8] *Ibid*: http://www.innovation.gov.au/factsheets/transforming-procurement-%E2%80%93-business-research-and-innovation-initiative

[9] https://www.sbir.gov/

This is necessary work producing real outcomes for government and society, which at the same time aids small business growth.

A live example is the US Navy - which uses 1.4 billion tonnes of fuel per year - funding small business research into energy efficiency and sustainability solutions.

RECOMMENDATION:

Expand the recently announced "Business Research and Innovation Initiative" to emulate the successful Small Business Innovation Research (SBIR) Scheme in the United States.

6. 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.

AAMC continues to encourage and support Government initiatives to improve small and medium sized enterprises (SME) capabilities and industry-research collaboration nationally. Public-private partnerships such as the Government's Industry Growth Centres and the Cooperative Research Centre program - building collaboration between globally-focused small, medium and large advanced manufacturers and Australia's leading research institutions - will be critical to improving Australia's economic future.

Australia's SMEs, 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 within the SME sector. Current measures for collaboration are not driving the right behaviours and outcomes. As such, the AAMC recommends the following 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.

7. Improve effectiveness of R&D incentives

The AAMC applauds the Government's decision in December 2015 to initiate a further review of the R&D Tax Incentive and the appointment to that review of chair of Innovation Australia Bill Ferris, the new Chief Scientist Dr Alan Finkel and the Secretary of the Treasury John Fraser.

The Review is 'to identify opportunities to improve the effectiveness and integrity of the R&D Tax Incentive, including by sharpening its focus on encouraging additional R&D expenditure.' It will report to the Government in April 2016.

As indicated in consultations to the Review, the AAMC strongly supports government tax incentives that effectively encourage greater commercial outcomes for Australian innovation and research.

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

We believe a well designed R&D tax incentive – and associated measures – will be critical for driving innovation and growth in advanced manufacturing.

Empirical research indicates that countries that invest significantly in R&D see better economic outcomes, particularly among SMEs.[10]

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.[11]

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[10] 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.

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

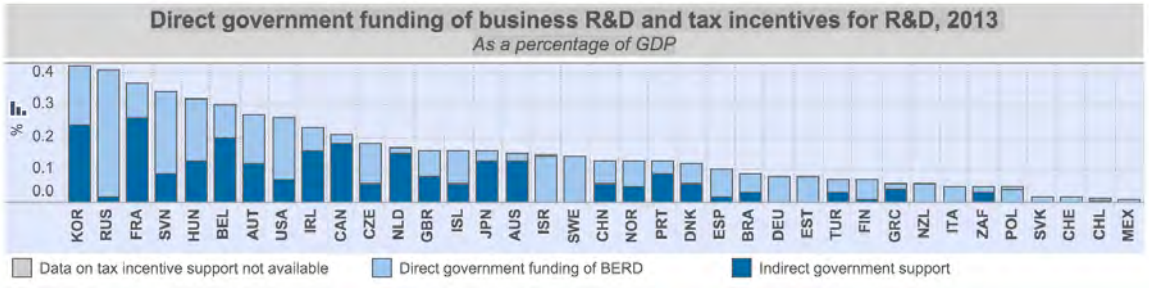
Investment in R&D results in tangible economic outcomes, driving product and process innovation in the economy and spawning new industries. In high-wage, high-technology economies, R&D investment is 'a prominent driver of technological innovation and economic growth'. [12]

In light of this, a move last year to place a $100 million cap on the R&D expenditures that companies can claim as tax deductions – coupled with suggestions that further cuts were imminent – was a significant backward step.

Instability in government programs can have enormous ramifications for future investment by multinationals (MNC), including our own MNCs, in R&D hub activity in Australia.

Australian Governments provide a comparatively low level of R&D support to business in the form of tax credits.

The OECD Science, Technology and Industry Scoreboard 2013 placed Australia towards the lower range of countries in direct and indirect government support for R & D. (See chart below)



Source: OECD R&D Tax Incentives Indicators, based on 2013 OECD-NESTI data collection on tax incentives support for R&D expenditures and OECD, National Accounts and Main Science and Technology Indicators, 15 December 2014. Direct funding estimates for Brazil are based on national sources; http://www.oecd.org/sti/rd-tax-stats.htm#government

[12] The Brookings Institution, p. 19.

Creating and retaining new industries

8. Introduce an Australian innovation incentive

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 family of innovative haemophilia products (recombinant coagulation) through biotechnology manufacturing methods. Australia was found to be uncompetitive and did not win the project.

This is just one example on the public record. Australian executives report there have been other lost opportunities.[13]

The AAMC study of Australia's competitiveness in terms of innovation tax incentives, *How Australia Compares*, found Australia lagging in 10th place out of 12 comparable nations studied.[14]

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 potentially significant – and growing.

The rush of countries taking up the idea of a "Patent Box" has led to suggestions that 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 IP that has been substantially developed and remains owned in Australia.

The Australian Innovation and Manufacturing (AIM) Incentive proposal was developed by a collaboration of Australian industry bodies and companies, including Cook Medical, to address this issue.[15]

CSL has also proposed a model to attract new investment to advanced manufacturing.

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[13] "10pc 'patent box' rate would boost manufacturing, report says", The Australian Financial Review, December 4, 2015.

[14] *How Australia Compares*: AAMC study of Australia's innovation tax competitiveness, December 2015.

[15] http://www.aimincentive.com.au/industry-support/stakeholders/

Unlike a 'patent box', CSL's Advanced Manufacturing Tax (AMT) proposal would not diminish existing tax revenues in that it would only apply to new investment that would not otherwise take place in Australia, and requires IP to be tied to advanced manufacturing. [16]

The AAMC strongly supports the above policy proposals to encourage new investments in advanced manufacturing in Australia.

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, as an example, 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.

The introduction of the UK's combined R&D tax relief and Patent Box for commercialising IP coincides with the UK recording three consistent years of growth in attracting Foreign Direct Investment.

The following examples highlight the intensifying competition:

- The **United Kingdom** in 2013 introduced the Patent Box which enables companies to apply a lower rate – 10% - of Corporation Tax to profits earned after 1 April 2013 from its patented inventions. UK companies can also claim generous R&D tax credits: SMEs are awarded tax relief of 230% on R&D revenue expenditure[17]

- **Ireland** will introduce a "Knowledge Development Box" offering 6.25% tax rate in 2016.

- **Switzerland** is proposing a License Box incentive to provide reduced rates of tax on IP-related profits. The draft License Box wording suggests the mechanism will be closely aligned with the UK Patent Box.

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16 CSL's submission to the Joint Select Committee on Trade and Investment Growth, Inquiry into Australia's Future in Research and Innovation, February 2016.

17 *How Australia Compares*, pp 27-28
Following recommendations made by the OECD as a result of its review of harmful international tax practices, the rules relating to Patent Box qualification will be tightened from 1 June 2016: from that date,
– IP entering the Patent Box regime must have been developed (or partially developed) in the UK.
– IP qualifying before that date will continue to enjoy the benefit of Patent Box until 2021, when it will be reassessed according to the new R&D requirement.

- **Singapore** 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:
    - 400% tax deduction up to a cap of $400,000 per year, or $600,000 for SMEs. The incentive extends to R&D activity conducted in-house or outsourced, and can be carried out in Singapore or overseas.
    - R&D expenditure over and above the thresholds qualifies for a 150% tax deduction.[18]

RECOMMENDATION:

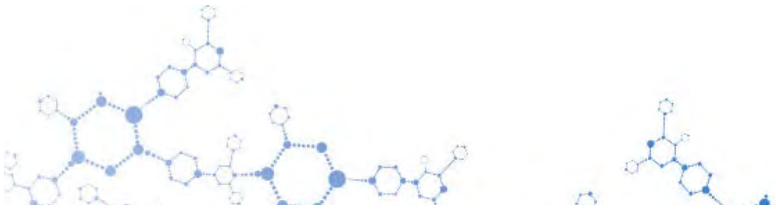
Introduce an Advanced Manufacturing Innovation incentive scheme to attract and maintain high value manufacturing in Australia.

This 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.[19]

[18] For further detail on the 12 countries studied, see Ibid, pp 17-29.

[19] *CSL's proposal for not more than 10 per cent on new advanced manufacturing suggests the following pre-requisites/conditions to qualify for the advanced manufacturing tax to include:*

- *new investment in advanced manufacturing facilities in Australia*
- *the value this new investment would be substantially derived from qualifying IP, including but not limited to IP*
- *the qualifying IP should be either developed in Australia or, if it is acquired IP, significantly enhanced through further expenditure under Australian ownership.*



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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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