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General Manager
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Email: rdtaxcredit@treasury.gov.au

Dear sir

The Group of Eight would like to provide the following response to the consultation paper *The New Research and Development Tax Incentive* released by the Government in September 2009.

The University Sector acknowledges the significant role played by Government in providing fiscal incentives to encourage the private and public sectors to engage in innovative activities and that the participation of Universities is pivotal to conducting research.

The University Sector believes that the introduction of a R&D tax credit system simplifies the current R&D tax concessions available to corporate entities and aligns Australia with its global competitors who also offer such tax credits and cashing out of these credits.

Encouraging Private Sector / University Sector Engagement

Governments at both a State and Federal level provide significant capital and research funding support to the University Sector to assist with both infrastructure and innovative research in areas of national importance as they recognise the need to support research excellence.

However, there is currently no financial incentive for industry to conduct eligible R&D activities by utilising the research knowledge already developed in a University or the infrastructure that is available. In many cases, corporate entities are replicating both the research and infrastructure at a significant cost to the entity when it is already available at a marginal cost within the University Sector.

This results in significant financial outlays which deter corporate entities from conducting high levels of R&D.

Currently, the level of corporate initiated research conducted with Universities (outside the CRC programs) represents only a small fraction of the total level of research conducted at a University.

The University Sector accepts that it has its part to play in developing methods to encourage industry.

Financial Incentive – Corporate/University Engagement

The University Sector believes that if a financial incentive exists for the corporate sector to investigate whether research could be conducted within a University rather than "in-house," then a significant increase in the level of corporate-funded research conducted in the university-sector would occur.

Currently, the Income Tax Assessment Act 1936 (ITAA 1936) provides an incentive for companies to claim a 175% tax deduction where their research activities grow significantly over a three year period. Under the existing system, a 125% incentive provides an after tax benefit of 7.5 cents in the dollar and the 175% incentive increases this benefit to 22.5 cents.

The Consultation paper indicates the Governments proposes a transition to a tax credit system providing for a 40% non-refundable tax credit (equivalent to 133% under the existing system) for larger firms whose grouped turnover is $20 million or more and a 45% refundable tax credit (equivalent to 150% under the existing system) for smaller firms whose grouped turnover is less than $20 million. Under the proposed changes, the 40% non-refundable credit provides an after tax benefit of 10 cents in the dollar and the 45% refundable credit provides a 15 cent incentive, significantly less than the existing 175% concession.

The Group of Eight proposes a differential be created above the 45% tax credit for University based corporate research as a means of encouraging industry engagement, regardless of grouped turnover. The incentive will increase the level of corporate research conducted at Universities. To attract the corporate sector to conduct research within Universities, we believe that the incentive to conduct research at a Registered Research Agency (RRA) should be equivalent to the existing 175% tax deduction or a tax credit of 52.50% under the proposed system. A 52.50% tax credit provides an after tax benefit of 22.5 cents in the dollar.

If the Government believes 175% (under the current system) or 52.50% (from 1 July 2010) to be excessive, then we believe that the corporate sector should at least receive an incentive equivalent to the highest benefit provided under the new proposed R&D Tax Credit system.

The ability of the University Sector to market this competitive edge to the corporate sector should increase the focus on utilising existing research infrastructure with a financial outcome that is significantly advantageous against that of conducting the research "in house".

The University Sector has not conducted detailed modelling as to the financial cost to the Federal Government of implementing this proposal. However, given the current extremely low levels of corporate research being conducted at Universities we believe that the cost of this R&D initiative is affordable in the current climate.

Financial Incentive - Investment Sector/University Engagement

In addition to increased engagement between existing industry and University research, the University Sector believes that the changes to the R&D Tax incentive program provides an opportunity to promote engagement between investment markets and University research. Australian Universities have been the source of intellectual property for new technology companies (start-up companies), many of which have proved to be high growth and high value companies, such as Resmed, Radiata, Melbourne IT and QRxPharma. Commercialisation via start-up companies is one of the major mechanisms for effectively translating university intellectual property to market application, and generates economic activity often near the source of original intellectual property.

Start-up companies are typically financed by early stage Venture Capital firms and Angel investors, with the initial shareholders being those investors and the University (or the University's technology transfer company). In the first instance, investors will typically hold a significant minority interest in the company; the University's interest representing the agreed value of the foundation intellectual property. It is also noted that many Venture Capital investors are structured as unit trusts and are precluded from taking a majority interest in their investee companies.

The Income Tax Assessment Act 1936 (ITAA 1936) currently provides for such start-up companies to claim a tax deduction (125% or 175%) on eligible R&D expenditure. However, many University start-up companies are not able to obtain the R&D Tax Offset (cash rebate) as the current Act has an upper limit of 25% on shareholdings or beneficial interests by tax exempt entities, such as Universities. The Consultation Paper proposes that the tax exempt limit for the 45% Refundable Tax Credit be raised to 50%. While this is welcomed, many early stage technology start-ups formed on university intellectual property will remain ineligible for the Refundable Tax Credit with a 50% limit. This is also the impact of the $20 million grouped revenue limitation where those entities form part of a University group of companies.

In proposing a cap on tax exempt shareholding, be it 50% or otherwise, the effect is that a start-up company founded on lesser value University intellectual property is more likely to access the Refundable R&D Tax Credit than is a company founded on more valuable intellectual property. Such a limit then makes start-up companies founded on University research outcomes comparatively less attractive to early stage venture financiers. This is not consistent with the Government's objectives for the National Innovation System or recent initiatives such as the establishment of Commercialisation Australia.

All start-up companies, including those emanating from the University Sector, should be treated equally under the new R&D Tax Incentive arrangements. They should be eligible for the Refundable R&D Tax Credit, with University shareholdings being exempted from the grouped revenue limits and no cap on the shareholdings of tax exempts. If there is to be an eligibility test to be applied to companies with shareholdings by tax exempts, then a requirement that there has been an arms-length investment in the company would be acceptable.

Conclusion

The key objective is to create a compelling change in the research landscape that encourages industry to engage with Universities and vice versa. We believe that the structural changes that have occurred in the University Sector in recent years highlight the imperative of Universities to expand their industry engagement initiatives.

A change such as providing a financial incentive via the R&D tax credit system to conduct research activities within a University environment could be one such compelling event.

Yours sincerely

Mr Michael Gallagher
Executive Director