Senate Economics Legislation Committee

Inquiry into the Treasury Laws Amendment (Research and Development Tax Incentive) Bill 2019

March 2020

Australian Fresh Produce Alliance
Growing a healthier Australia

About the Australian Fresh Produce Alliance

The Australian Fresh Produce Alliance (AFPA) is made up of Australia's key fresh produce growers and suppliers. The members include:

- Costa Group,
- Perfection Fresh,
- Montague,
- One Harvest,
- Pinata Farms,
- Fresh Select,
- Mackay's Banana Marketing,
- Driscoll's,
- 2PH Farms,
- LaManna Premier Group,
- Rugby Farming,
- Freshmax, and
- Fresh Produce Group.

These businesses represent:

- half the industry turnover of the Australian fresh produce (fruit and vegetables) sector - $4.5 billion of the $9.1 billion total,
- a quarter of the volume of fresh produce grown in Australia - 1 million of the 3.9 million tonne total,
- more than a third of fresh produce exports - $410 million of the $1.2 billion export total,
- more than 1,000 growers through commercial arrangements, and
- more than 15,000 direct employees through peak harvest, and
- up to 25,000 employees in the grower network.

The key issues the AFPA is focusing on include:

- packaging and the role it plays in product shelf life and reducing food waste landfill,
- labour and the need for both a permanent and temporary supply of workers,
- market access to key export markets for Australian produce,
- product integrity both within and outside of the supply chain,
- pollination and research into alternative sources, and
- water security, including clear direction as to the allocation and trading of water rights.

The AFPA's aim therefore is to become the first-choice fresh produce group that retailers and government go to for discussion and outcomes on issues involving the growing and supply of fresh produce.

Products grown by AFPA Member companies include:

Apples	Blueberries	Cherries	Nectarines	Raspberries
Apricots	Broccoli	Fioretto	Onions	Salad leaf
Asparagus	Broccolini	Green Beans	Oranges	Spinach
Avocado	Brussel Sprouts	Herbs	Peaches	Strawberries
Baby Broccoli	Butternut	Lemons	Pears	Sweet Corn
Baby Corn	Pumpkin	Lettuce	Pineapples	Table grapes
Bananas	Cabbage	Mandarins	Plums	Tomatoes
Beetroot	Cauliflower	Mango	Potatoes	Water Cress
Blackberries	Celery	Mushrooms	Cucumber	Wombok

Introduction

As with many industries the fresh produce industry must invest in R&D to improve both its technical and production capabilities, while ultimately improving profitability. An R&D tax system which recognises the requirement for such investment and the level of risk associated with this is therefore crucial to ensuring industry continues to invest in R&D.

There is both a public and private benefit from R&D investment through increased productivity and capital creation which contribute to GDP growth and our standard of living. Fresh produce plays a unique role in providing healthy and nutritious food for our population which is needed to maintain health and well being and reduce public expenditure on what are chronic and preventable diseases, including type II diabetes and obesity.

R&D intensity test

In the 2018/19 Federal Budget various measures were announced to overhaul the existing R&D tax incentive regime, including the introduction of an R&D expenditure intensity test applicable to companies with an aggregated annual turnover of $20 million or more.

This measure was considered by the parliament in 2019 and the Senate Economic Legislation Committee asked that the proposed changes be reconsidered including a reworked formula for the intensity test.

On December 5, the Government has reintroduced a new bill however in most aspects it is identical to the previous bill including the measure seeking to tie the rates of the non-refundable R&D tax offset to the incremental intensity of R&D expenditure as a proportion of total expenditure for the year. The marginal R&D premium has been simplified compared to the original bill with now three bands of R&D spend intensity proposed as follows:

- Four and a half percentage points for R&D expenditure between 0% and up to and including 4% R&D intensity
- Eight and a half percentage points for R&D expenditure greater than 4% and up to and including 9% R&D intensity
- Twelve and a half percentage points for R&D expenditure above 9% R&D intensity

The new bill is to apply to tax years commencing after 1 July 2019.

Potential impact on fresh produce industry

Research and development is vital to the fresh produce industry's operations and its growth objectives, as it continually seeks innovative solutions to technical agronomical challenges and opportunities to maximise the quality and variety of its fresh produce. The current R&D tax incentive benefit of 8.5% of R&D expenditure has been an important financial incentive for the industry to continue to undertake research and development activities while being able to absorb some of this risk through the tax system.

If the R&D intensity test were to be enacted in the form described above, the incremental tax benefit for R&D activities for one major fresh produce company would likely reduce by 50% as illustrated below using rounded cost data for financial year ended 30 June 2018.

Example of Major Fresh Produce Company

R&D Expenditure	$6.2 million
Total Expenditure	$816 million
R&D Intensity	0.8%
Incremental R&D tax benefit available	4.5%

It is clear that the current design of the R&D intensity test would be unnecessarily punitive to high-cost industries such as the fresh produce industry. It also introduces uncertainty for industries making R&D investment decisions and has the potential to create inequality for domestic versus foreign owned entities undertaking R&D activities in Australia.

Fresh produce companies are undertaking genuine R&D in order tackle various technical challenges, improve environmental adaptability and to maximise opportunities for growth. Therefore, AFPA agrees with the original feedback from the Senate Economics Legislation Committee that the R&D intensity formula should be reworked in close collaboration with high cost industries, or better still, urge Government to reconsider the introduction of a R&D intensity test at all.

Key Points

- The Bill fails to address concerns of the previous Senate Economics Legislation Committee.
- The Bill was opposed by companies and industries in their submissions to the Committee, which was ultimately acknowledged in the Committee's February 2019 report.
- The Bill risks unintended consequences including:
  - companies may reduce or cease R&D activity in Australia; and
  - companies may re-structure their operations to offshore non-R&D activity such as manufacturing which supports Australian jobs.
- R&D intensity measure flaws:
  - The base benefit intensity rate of 4.5% is almost half of the current benefit. The vast majority of companies will not be able to achieve an intensity rate higher than this, which is tantamount to abolishing a tax incentive which has been available for 35 years. This is because increased compliance costs (as flagged in the Small Business and Family Enterprise Ombudsman's report in December 2019) mean the cost/benefit equation is marginal at best. As a result, many companies that have undertaken incremental R&D will cease to do so; they will either defer R&D at the expense of market opportunities or undertake it in the myriad of countries, such as New Zealand and the UK, which are increasing their support for R&D.
  - The 'intensity' mechanism calculates a company's R&D intensity based on annual expenditure which is not known until after year end. The proposition that this intensity measure could be part of an incentive which seeks prospective investment is, therefore, fundamentally flawed.
  - High cost base companies are negatively impacted as compared to low cost base companies since high cost base companies have total expenditure relative to R&D that is relatively high due to their higher cost of goods and operational expenses. This means that their R&D spend is not a true reflection of their 'real' R&D intensity;

    - Consolidated groups are negatively impacted as compared to unconsolidated groups since consolidated groups are likely to have higher overall expenditure when compared to unconsolidated groups where the R&D member of the group will have a high R&D to total expenditure ratio when calculating intensity.
- It is widely acknowledged that R&D incentives work to enhance productivity growth, increase business expenditure on R&D and grow jobs. At a reported cost of $3 billion (this reported cost requires further analysis, refer to section “Cost of the R&D Tax Incentive does not take into account key offsetting factors”), the R&D Tax Incentive sees over $12.2 billion of business R&D expenditure registered. This suggests a healthy return on its investment even at a reported cost of $3 billion.
- The Small Business and Family Enterprise Ombudsman recommended that the R&D Tax Incentive be retained as it significantly incentivised smaller firms to undertake R&D, but its administration by both regulators requires reform.
- The Bill will adversely affect almost all companies currently claiming the R&D Tax Incentive. More than 80% of current claimants have a turnover of less than $20m p.a. additionally, the majority of claimants are Australian-owned firms.
- Large and multi-national companies spend a considerable amount of expenditure on R&D p.a. (hundreds of millions) and this Bill will impact the ability of large companies to employ staff and continue to increase their R&D spend in Australia as compared to other jurisdictions with more favourable R&D incentives.
- Advances in data and analytics are driving change with data and software driven R&D becoming ever more essential. Indicative of this, almost half of all R&D in Australia is software based but as it is also highly mobile, there is a real concern that a lack of support in Australia will drive it offshore.
- Globally, the Australian R&D Tax Incentive is increasingly less attractive (due to reductions and instability), especially when compared to other jurisdictions (e.g. New Zealand or the UK). Australia already has a shortage of Science, Technology, Engineering and Mathematics (STEM) professionals and we need Government to support business to invest in STEM jobs which are critical to our future economy.
- The Bill is retrospective.

Key Recommendations

- Separate Schedule 1 from the current Bill so that less contentious elements of the legislation can proceed through Parliament expeditiously.
- The Government form a technical working group comprising Commonwealth Treasury and relevant tax and industry representatives to develop an alternative approach which can genuinely incentivise R&D investment while protecting local jobs and continuing to grow Australia’s STEM capabilities. This working group could consider alternative settings for a more effective proposal to be included in the R&D Tax Incentive program design, including benefit rates, more accurate modelling of costs of the R&D Tax Incentive program and spill-over benefits, turnover thresholds and optimal commencement timing.

This will be the third time the Government has reduced the R&D Tax Incentive since it was introduced in 2011-12. While we support measures to make the R&D Tax Incentive more effective, we do not believe the current Bill will achieve that goal.

Instead, it will create the risk of significant unintended consequences while reducing Australia’s ability to undertake more ambitious R&D projects and disadvantage us from our international competitors who have access to more generous R&D incentive regimes.

Conclusion

The membership of the Australian Fresh Produce Alliance is extremely concerned about the changes to the R&D Tax Incentive under the *Treasury Laws Amendment (Research and Development Tax Incentive) Bill 2019*. The changes will decrease the incentive and benefit for Australian fresh produce companies to undertake R&D, innovate and invest in the future. Australian farmers face the challenges of a changing climate and an increase in natural disasters as we have seen in the fires and floods in late 209 and early 2020. Australia is a high cost economy which continues to become less globally competitive.

The proposed changes will have two impacts: R&D in Australian fresh produce companies will decrease due to cost pressures and the reduction in incentive. Where R&D does occur, Australian companies will increasingly invest offshore to build the capability, technology and innovation in countries where the policy environment is supportive of R&D, innovation and business growth. We urge the Senate to reject the changes in the current form and develop appropriate measures to support Australian jobs and business.