

Ausmelt Limited submission in response to the Consultation Paper “The new research and development tax incentive”

To Be Submitted:
via email to rdtaxcredit@treasury.gov.au
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Summary

After considering the points raised in The Treasury Consultation paper, the views of Ausmelt are;

- **Additionality.** It is presently unclear as to how additionality will be represented in the legislation. In its current form the concept is open to debate in assessing eligibility claims under the new scheme and as such any legislation should be clear that it is **NOT** a measure or test of eligibility.
- **Core vs Support Activities.** There are significant industry differences between R&D conducted for various industries (eg, Biology, Software, Engineering) and depending on the criteria used for limiting the core to support activity ratio, the whole scheme may be rendered ineffectual for Ausmelt as well as many other Engineering field SME's which is in contradiction to the stated intention of the scheme.

In addition, Ausmelt believes that the proposed changes will likely result in no overall benefit, especially for SME's as any face value benefit will likely be offset by limitations to eligibility criteria for support activities and increased compliance costs.

Ausmelt Limited & Our Submission

Ausmelt Limited, an Australian based and owned SME, is a leading international supplier of Top Submerged Lance (TSL) smelting technology to non ferrous metals producers around the world. With over 25 years in the metals industry, Ausmelt has achieved commercialisation of its technology globally with the installation almost 50 TSL furnaces for a range of major international organisations.

Ausmelt Limited (ASX code AET) is listed on the Australian Stock Exchange. The company employs over 40 specialist staff and continues to develop and improve its technology. In doing so, Ausmelt partakes in various approaches, including the current R&D Tax Concession system. It is for this reason that Ausmelt has prepared this submission in response to the Australian Government Treasury Consultation paper, *"The new research and development tax incentive, September 2009"*.

The views presented in this submission reflect Ausmelt's approach to R&D and its own opinions and observations of the proposed government changes. It is our belief that such views may be typical of many other SME technology development companies and The Treasury is encouraged to see them in this light especially as SMEs are the backbone of any economy.

Overview comments

Ausmelt appreciates the approach taken by The Government in allowing for a range of options to be considered. Whilst giving a broad view of the thought processes behind the proposed changes, it does give rise to much uncertainty, with a range of possible implementable options and combinations thereof that arise from the proposed legislation. This makes it rather difficult for Ausmelt to assess the likely impact of the new scheme on its activities due to this uncertainty.

Additionality

Ausmelt attended the Consultation forum held in Melbourne on Friday, 16th October. At this session, the concept of additionality was discussed in some length. It is understood that this is a vision for the scheme and will **NOT** be used as a measure of eligibility or test for whether claims are allowable. It is important that this is made clear in the legislation and is not left open to interpretation at some later date. If additionality is allowed to be used as a measure it will be impossible for technology companies such as our own to validate whether any claim would not have otherwise occurred. Whilst this is recognized in the Consultation paper under Item 49, the same item goes on to state, “*..the principle of additionality and spillovers will underpin the design of the rules for what activities will be eligible for the new R&D tax incentive*”. Ausmelt believe that this alone leaves the concept open to debate in assessing eligibility claims under the new scheme and as such any legislation should be clear that it is **NOT** a measure or test of eligibility. In the end any unclear changes or definitions which are open to interpretation will ultimately lead to wasted effort and wasted money.

Core and Support Activities

From both the Consultation paper and the Melbourne Forum discussions it is obvious that the prime concern of the Government involves the perceived ratio of Core to Support activities. Although no current ratio was proffered when the subject was raised, the view of the panel at the Melbourne forum was that from past audits and “*...a general feel around the office...*” the ratio was known. This was a troubling statement (due to reasons given in previous section), but we must assume that some modeling has been done to establish that this ratio needed to be the target of the new legislation proposed.

From our perspective, too much focus on limitations and restrictions related to core versus support activities may render the whole scheme meaningless to SME's such as Ausmelt. This is not the intended outcome of the proposed changes as SME's are the intended focus group meant to benefit.

In reference to the Frascati manual which is used to define Core and Support activities, the Consultation paper defines that *“Supporting activities are carried on for a purpose directly related to carrying on core R&D”*. It is therefore clear that actions taken to reduce or minimize claimed expenditure for support activities will have a direct impact on whether core activities can be conducted at all.

Ausmelt considers a better alternative approach could be based on an over-arching project focus rather than the activities of which it is comprised. In the traditional project based approach, activities are the individual tasks undertaken. If the purpose is to strip down activities to this level then one can expect a high core to support activity ratio.

For example, Ausmelt undertakes pilot plant trials to investigate a new process for a client to expand the boundaries of the technology and maintain its place as the cutting edge of Best Available Technology (BAT). Of the activities involved, it may be viewed that only the actual trials are core (meeting both requirements of high technical risk and innovation), but the preparation and analysis with sophisticated models and simulation supported by scientific insights of results are required to ascertain success. An untrained eye and inexperienced evaluator in the art of R&D could however otherwise view these as purely support activities. Obviously only the total combined activities can provide the conclusion whether the work was successful or not. Therefore, subject to the proposed limitations for support activities, either singly or in combination, could likely result in many SME's simply abandoning the scheme. In a project based approach, limitations could be applied to an overall project cost or linked to a proportion of company revenue. Larger innovative projects would likely find greater benefit from other avenues for funding provided in the range of grants currently available.

Ausmelt believe that if there is not simply an option *“f) none of the above”* to Question 4 of the Consultation paper relating to the available options provided, the sole purpose test may be best suited to limiting spurious support activity claims as characterized by Item 61 of the Consultation paper, changing the definition to *“other activities that are carried on for the sole purpose of supporting the carrying on of [core activities].”*

Other considerations

In addition to the points made above, the Consultation paper does not cover some other important aspects of the revised scheme. This includes clawback, which was cited as being lacking in the current scheme and the intention simply left as *“simplify and clarify”*. Changes from this point forward do not allow for any consultation as they will appear in the draft legislation given the timing involved.

Ausmelt also agrees that software should be included in the scheme as it is becoming entrenched in many aspects of technology and product development. Ausmelt is of the view that software should **NOT** be treated in any different manner than other R&D projects whether it forms a whole or part of an overall project.

R&D to be conducted in Australia

As an Australian based company developing for a largely overseas market, Ausmelt has experienced some instances where a portion of important R&D activities can only be conducted overseas. Ausmelt consider that there should be exceptions to the general rule that R&D only be conducted in Australia and this could be limited to clear cases where it can be shown that components of a total R&D project can only be carried out overseas.

For example, whilst Ausmelt can conduct R&D to the pilot plant scale at its own facility in Australia, the scale-up of processes being developed can only be conducted in real scale commercial operations at one of its client's overseas facilities. It should be noted that in this example, the claim should **NOT** include the entire operation of an overseas plant for that period, rather the costs incurred by the Australian company conducting the R&D project in being present for such work and rendering expert knowledge, experience as well as implementing proprietary modeling and design tools to try and make every endeavour to ensure success of the work. Such an approach benefits Australia by bringing revenue in earlier, rather having an extended delay in bringing new processes to commercial scale by local government funding.

AusIndustry Guidelines

Guidelines will be vital to the success of the system, especially in terms of compliance. The self assessment approach shifts more burden onto the recipient company and does nothing to assist with R&D planning, thus adding to the cost burden of partaking in such a scheme. This alone may offset any proposed tax benefit over the existing system.

The view taken during any future assessment will draw on the clarity of AusIndustry guidelines and examples are crucial to understand what position will be taken in auditing claims. Such major changes to the scheme will necessarily result in uncertainty, especially in understanding of the system and whilst the Consultation approach taken is a great platform for taking into account views into account of the various proposed options, it cannot allow for certainty in determining its impact.