

Ford Motor Company of Australia Limited

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General Manager
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The Treasury
Langton Crescent
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By Email: rdtaxcredit@treasury.gov.au

Dear Sir/Madam

We write in response to a public invitation for comment on issues canvassed in the consultation paper "The New Research and Development Tax Incentive". We appreciate the opportunity to provide comment. Our contribution will provide some background material and address specific issues where Ford Motor Company of Australia Limited (Ford Australia) has particular knowledge and interest.

Ford Australia is one of Australia's largest private sector investors in research and development. It is a leading automotive company with approximately 4000 employees and extensive design, engineering and manufacturing facilities located in Broadmeadows and Geelong, Victoria. Its core products are the Ford Falcon and the Ford Territory. In 2008, Ford Australia sold 104,715 locally-manufactured and imported vehicles. A further 4,042 locally-manufactured vehicles were exported, primarily to New Zealand.

In 2006, Ford Australia announced a new strategic direction for the company, including significant investment in new projects and facilities. A key element in this new strategy was an expansion of Ford Australia's research and development capability, and its enhanced role as a design and engineering "Centre of Excellence" for the Asia Pacific & Africa region. Under this umbrella, Ford Australia has been the lead design and engineering source for the recently launched Ford Figo small car in India and for a yet-to-be launched compact pick-up truck which is to be sold in more than 100 countries.

Ford Australia also announced in July 2009 its intention to invest \$230 million in a suite of environmentally oriented new vehicle initiatives including the introduction of four cylinder EcoBoost and liquid injection LPG technology for the Ford Falcon and clean diesel technology for the Ford Territory.



In each of the abovementioned global and local new product programs, Ford Australia's designers, scientists, researchers and engineers have been able to utilise their expertise and skill-sets in developing a wide range of new vehicles that can be competitively sold alongside vehicles produced in automotive power-house economies throughout the world. This capability, originally nurtured on vehicles like the traditional six cylinder Ford Falcon, has been built up over many years and reflects the dividends of automotive policy and research and development investments made by the broader Australian community.

Ford Australia believes a global characteristic of technically-based industries, such as automotive manufacture, is the evolutionary nature of product development. This reflects the enormous capital demands of the industry. It generally means the relative competitiveness of any model within an intensely competitive market will be underpinned by a mixture of incremental and advanced research and development. Activities under each element carry significant technical and commercial risks. A passenger motor vehicle, for example, that does not benefit from continuous technical refinement and manufacturing process improvements will over a short period of time become uncompetitive relative to other similar vehicles in the market place. In the case of the Australian new vehicle marketplace, there are more than 50 different brands and 350 different models from more than 25 source countries competing for custom.

It is therefore quite logical to suggest that innovation, centred on both incremental and advanced research and development activities, is fundamental to the viability and competitiveness of the automotive industry where the creation of a new model vehicle represents a catalyst for considerable innovative activity. With such activity comes significant and wide-ranging spillover benefits including employment creation, extensive supplier and service provider linkages, export success, enhanced environmental and safety performance and the development of new manufacturing processes. The extent of this, and the inter-relationship of many actions strongly suggests a broad approach should be taken by policy-makers when designing and developing public support programs.

Ford Australia now competes on a global basis for its research and development projects. An increasingly globally integrated Australian automotive industry has significantly broadened the boundaries of design competition. This also means that at a time of substantial change in the global industry – where a wide range of cancelled investment initiatives by many companies in many countries has created significant research and development over capacity – Ford Australia must compete vigorously for new research and development projects.

A key centrepiece of the Government's support of innovation has long been the R&D tax concession. Ford Australia believes this initiative has played a very important role in fostering an innovative culture across different sectors of the economy. It has assisted significant R&D investors like Ford Australia in managing the risks associated with R&D activities. Ford Australia acknowledges the Government's intent to substantially change this policy initiative, and change its base from that of a tax concession program to a tax credit based program. Ford Australia also acknowledges the principle of seeking a policy foundation where Australian companies grow their research and development activities. It believes its own achievements in recent years is testimony to what can be achieved with the right policy and industry environments.

Ford Australia respects the Government's wish that the new tax incentive scheme be revenue neutral over its first four years of operation. By proposing to use policy design to achieve this objective, Ford Australia believes considerable care must be taken. It would be extremely unfortunate if budgetary objectives resulted in an unintended impact on the integrity and scale of a growing research and development sector in Australia.

Ford Australia therefore believes it important that the Government adopts a cautious approach to defining the underpinning structure of the new policy arrangements. In this context, the company believes it would be a step too far to both tighten the definition of R&D, by substituting innovation or technical risk to innovation and technical risk and for the purpose of producing new knowledge and improvements, and to also significantly tighten eligible expenditures on support activities. The tightening of the definition in this manner is likely to cause considerable difficulty for the automotive industry. It can also be expected to create uncertainty and compliance complexity. Furthermore, it also creates a multiplier effect by reducing activities from being eligible core activities, it then effectively reduces the eligibility of activities that would be critical support activities. This double-step would therefore have a considerable impact on the accessibility of key innovative industries with broad cross sectoral linkages and demonstrated commercialisation capabilities, such as automotive, to the R&D tax credit scheme.

Ford Australia believes it important Australia pursues broad international competitiveness with regard to R&D policy frameworks. This is particularly relevant recognising Australia's relative scale versus developed and rapidly developing economies, and the increasing global mobility of R&D activities. In essence, it is important large global R&D investors look toward Australia as a location offering competitive skills, costs and policy frameworks. Regrettably, Ford Australia believes the proposed definitional change for core R&D activities from "innovation or high levels technical risk" to "innovation and high levels of technical risk" would give Australia one of the most restrictive R&D definitions among the OECD countries including Canada and United States. In addition, the new definition will not be aligned with the Frascati Manual. This would have a negative impact in justifying new R&D investment initiatives in Australia, in view of the increased costs when quantified on an "after tax basis".

Ford Australia also believes it would be detrimental to place new limitations on the eligibility of supporting R&D. The current tax concession provides assistance for the cost of R&D initiatives. These activities can include the design and construction of apparatus used directly for experiments such as a pilot plant and the design, construction and operation of prototypes used in experiments. Ford Australia believes such activities are fundamental to the success of R&D programs. They can also be quite costly. Any attempt to reduce support for such activities would have the same effect as reducing or removing support for core R&D.

Ford Australia believes the proposed changes represent a move from the well understood industrial definition of R&D toward a more scientific definition. Such a move can be expected to penalise manufacturing industry. It also potentially under-values the commercialisation outcomes achieved under the present system. Ford Australia can readily point to its demonstrated ability to bring much of its extensive R&D work to market. Three examples are the dedicated LPG Ford Falcon, the Ford Territory and the ACART joint venture/collaboration. Ford Australia was the first local manufacturer to complement its supply of petrol-fuelled vehicles by offering dedicated-LPG variants of the Ford Falcon. These vehicles were first introduced in 1999. More than 90,000 dedicated-LPG Ford Falcon

vehicles have now been sold with extensive economic and environmental spillover benefits to component suppliers and vehicle purchasers and the wider community, particularly during a period of rising fuel prices. The Ford Territory was the first SUV to be designed, engineered and manufactured in Australia. It reflects a program investment of more than \$500 million, incorporates substantial local content developed by and sourced from Australian suppliers and was the top-selling SUV in Australia for a number of years following its launch in 2004. The development of the Ford Territory also saw the first introduction of dynamic stability control (DSC) to a locally-made vehicle. The introduction of this advanced safety feature involved considerable technical challenges. This reflected the wide diversity of sealed and gravel/dirt road surfaces in Australia and the unique electronic calibration necessary to manage such conditions. The introduction of DSC followed a comprehensive multi-million dollar development program by Ford and Bosch engineers totalling more than 200,000 man hours, computer-aided engineering virtual testing of more than 20 million kilometres and real-world testing in more than eight countries in a wide range of climatic extremes. The Advanced Centre for Automotive Research and Testing (ACART) is a collaborative undertaking between Ford Australia, the University of Melbourne and the State Government of Victoria. It seeks to provide the local automotive and transport industries with state-of-the-art infrastructure and highly skilled personnel. The Centre is located at two nodes near Geelong and Parkville. It incorporates a clean diesel fuel emissions facility, environmental laboratory and an engine dynamometer facility. These facilities will each have third-party access.

We would be happy to discuss these issues in greater detail. The writer can be contacted on (03) 9359 7142 or at rscoulal@ford.com.

Yours sincerely



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