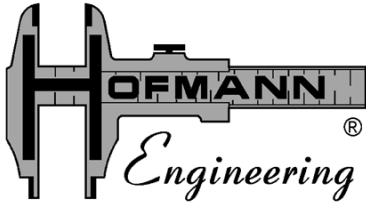


Hofmann Engineering Pty. Ltd.



3 ALICE ST, BASSENDEAN, PERTH
WESTERN AUSTRALIA 6054

A.C.N. 114 806 969 A.B.N. 39 114 806 969
TELEPHONE: (+61 8) 9279 5522
FAX: (+61 8) 9279 9386

EMAIL: mail@hofmann.net.au
<http://www.hofmann.net.au>



12 October 2009
General Manager
Business Tax Division
The Treasury
Langton Crescent
PARKES ACT 2600

By email: rdtaxcredit@treasury.gov.au

Submission on "The new research and development tax incentive"

Hofmann Engineering Pty Ltd welcomes the opportunity to make a submission toward the Treasury's Consultation Paper on the new Research and Development tax incentive.

About Us

Since 1969 Hofmann Engineering has provided specialist engineering services to Australia's industry leaders. Quality Assurance accreditation by Bureau Veritas complements our total quality culture. Hofmann Engineering staff and management alike pursue a single goal - a total focus on quality in every aspect of manufacture, customer service and on time delivery. Our individual skills and experience are what underlies our reputation as a self-reliant engineering company with all resources "under one roof". Our management is structured to attain the highest quality through a "hands on" approach to every project. Problems are treated as challenges, while innovation provides solutions for our clients.

For over 40 years Hofmann Engineering's philosophy of continuous product improvement has given customers' assurance that their engineering challenges will be thoroughly considered and, through Research and Development, optimal solutions obtained. Innovation and technological improvement is the essence of our survival because developing and refining new processes and methodologies maintains our competitive advantage internationally against competition from low cost countries. We have a dedicated R&D team focusing on the future needs of our customers in addition to their everyday requirements so that we constantly evolve and improve our technology to refine our products and our service.

The company has been fortunate to receive R&D grants over the years and the combination of grant and tax support has underpinned the enormous growth of this Australian success story. Hofmann Engineering has grown from two brothers working in a garage to one of the largest private engineering firms in Australia employing 450 staff producing from three sites in Australia to international markets. Since inception all profits have been re-invested into the business and the company can proudly say we have never retrenched any staff.

The Case for Reform

Hofmann Engineering understand the overall intent of the policy objectives are to continue to support Australian R&D activity at similar levels to prior years, and to provide support to the types of R&D that will provide the most in terms of spillover benefits. We believe that Hofmann Engineering are the type of company the R&D Tax incentive scheme is targeted towards, as we are a fast growing medium sized Australian owned and operated international manufacturer so providing enormous spillover benefits to Australia.

Principal 1 – Australian R&D

We agree with providing R&D support for Australian companies.

Principal 2 and 3 – Tax credits

We agree unused tax credits should be used to offset future tax liabilities.

Principal 4 - Administration

We support continued R&D Administration under similar structures to existing frameworks.

Principal 5 – What is R&D

We support the intention to define eligible activity under the principle of additionality and spillover benefits. We are concerned about the practicality of proving activities would not have been undertaken otherwise as this will be subjective and unquantifiable due to the very nature of R&D but we appreciate that the intention of additionality is overarching rather than project specific.

Principal 6 – Core R&D

It is proposed that core R&D eligibility be defined to involve both innovation and high technical risk as opposed to the current legislation that supports one or the other. The tightening of eligibility for the new R&D tax incentive would not result in a revenue neutral program for Hofmann Engineering or many Australian manufacturers due the increased restrictions imposed by meeting both simultaneously.

By way of example, Hofmann Engineering designed and introduced manufacturing of forged fabricated girth gears to the international market for mine site ball mills. Cast gears were the standard but these only achieved several years life expectancy and mill downtime costs mining companies millions of dollars. We innovated by utilising stronger forged steel plates, bending and welding these into mill gears so providing a premium product that lasts longer. This process also involved high technical so the criteria was met.

The global market has collapsed and companies are postponing projects and saving money wherever possible. Cast gears cost less so, despite the benefits, forged gears are no longer able to command a premium to offset the increased cost. Hofmann Engineering have recognised this and, among other changes, adopted untested and more complex twin arc welding technology to drastically reduce welding time thus saving significant costs however greatly increasing technical risk. These drastic process changes are necessary to compete in a cost-focused international market. Without pursuing such risky projects Australian girth gear manufacture would be uneconomical. This does not involve innovation but great risk that would otherwise not support an Australian girth gear industry.

We believe that the tightening of the R&D eligibility criteria would negatively influence industries performing true R&D toward our perceived intent of additionality and spillover benefits. The aim to migrate claims away from 'whole of mine' projects can be achieved without tightening this definition to the detriment of broader industries but instead by narrowing the scope of additionality or the causal link to the core activity.



Principal 7 – Supporting R&D

Our supporting activities are essential to the development of core R&D and in our project-based heavy engineering manufacture the scope of such activities will be variable and project dependant. R&D projects by their very nature are open ended and will not involve fixed percentages of supporting activities. We therefore suggest supporting activities should be eligible where their sole purpose is the support of core activities.

New designs created by our drawing room are an example of type of activity that may be affected.

For example, Hofmann Engineering's project plans all require extensive design and draft work. The designing process is a supporting activity as technical risk does not exist in the drafting/drawing process itself, but in the manufacturing processes following the design. New intellectual property is often developed on the drawing board, and as such these supporting activities are crucial to extracting the benefits of R&D. This is also true of most of our engineering work as we investigate the optimal means of improving a product.

Excluding production activities and dual role activities from R&D would limit the spillover potential that saleable prototypes provide. As a project based manufacturer saleable prototypes are the main means by which Hofmann Engineering have been able to conduct R&D, due to the restrictively high costs of manufacture. The success of these innovative or technically risky R&D processes and procedures requires extensive testing under extreme and variable operating conditions over many years that can not be duplicated in a laboratory.

We believe that eligibility need not exclude supporting activities undertaken predominantly for the purpose of supporting core R&D. For Hofmann Engineering these supporting R&D activities provide spillover benefits in conjunction with and as an integral part of our core R&D activity.

Summary

As Australia emerges tentatively from the worldwide financial crisis relatively unscathed, now is the time to encourage R&D investment by Australian owned and operated companies with proven R&D track records in order to generate the greatest spillover benefits for Australia at large. R&D projects involve innovation or technical risk but tightening the definition to require justification of both risks stifling Australian investment and ultimately reducing Australian competitive advantage in a cost focused world market. We also propose that supporting R&D undertaken for the specific purpose of supporting a core R&D activity is encouraged in order to support Australian manufacturing innovation.

We submit that revenue neutrality is attainable while ensuring any legislation changes do not impinge on the Australian manufacturing industries by instead limiting 'whole of project' claims that delegate risk and innovation to suppliers while large project owners claim disproportionate shares of the tax windfalls. This is attainable through overarching additionality principles and ensuring supporting activity is integral to core R&D rather than narrowing core R&D tests and capping supporting R&D.

Yours Sincerely,

Martin Dowling
Chief Financial Officer
Hofmann Engineering Pty. Ltd.

