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Dear Sir

**Metso Minerals (Australia) Limited Submission on Research and Development Tax Incentive Consultation Paper**

Metso Minerals (Australia) Limited (“MMAL”) welcomes the opportunity to contribute commentary on the Consultation Paper released September 2009 regarding the new Research and Development (“R&D”) tax incentive.

MMAL is a dedicated proponent of innovation and technology in Australia and has been a positive contributor to the Australian community and resultant benefactor of the R&D Tax Concession scheme for numerous years. The growth of R&D and the benefits that this realm can provide to industry is critically important in ensuring Australia remains as a strong global competitor and marketable location for inducing companies to recognise Australia as a global platform for R&D excellence. The proposed R&D Tax Credit scheme provides MMAL with affirmation that the Government is seeking to improve the R&D incentive scheme by delivering effective support to business R&D.

A national R&D incentives scheme that is industry-supportive across the value chain from large corporations to small to medium-sized enterprises will instil operational confidence in firms residing in, and undertaking a programme of R&D within Australia.

It is without preconception that we note the attached submission solely represents the position of MMAL.

Yours faithfully

David Vlahov  
Company Secretary

Alex Gaskin  
Tax, Construction and Projects & Systems  
Accountant

## **Executive Summary**

MMAL appreciates the intention of the Government to make significant changes to Australia's R&D tax incentive scheme and the opportunity the Government has provided Australian firms to provide feedback through the consultation process.

MMAL supports the objective of the reform in which a more effective support platform is delivered for business R&D and in targeting this support to produce net-benefits for the Australian community.

Consequently, MMAL holds a positive view towards a number of proposals in the Consultation Paper. These include:

- The increase in the after tax benefit from 7.5 cents per dollar to 10 cents per dollar; and
- The shift of focus from the location of intellectual property ownership to that of the location of R&D with regard to eligibility.

However, MMAL also holds a high level of concern towards a number of aspects and the operation of the proposed R&D Tax Credit scheme. These include:

- Concerns pertaining to the definitional dual criteria test of innovation and high levels of technical risk;
- The impracticality and impact related to the restriction of supporting activities; and
- The revenue neutral stance combined with the intention to increase support for SMEs at the expense of large companies.

## **R&D Incentives Consultation Paper Discussion**

MMAL will take the opportunity to directly address each stated principle.

### **Principle 1**

*The new R&D tax incentive will be available to companies incorporated in Australia for R&D conducted in Australia. Location of the resulting IP will not be relevant.*

MMAL is part of a multinational organisation, conducting R&D in a number of countries around the world. R&D conducted in each of these locations is part of the overall group's intellectual property. Centres of excellence are placed in different locations around the world to focus on specific technology developments. Once new technology is developed and proven in one country it is available to other entities within the group to commercialise in their regions of operation.

In some circumstances specific intellectual property ownership maybe retained in the head entity, however this does not limit the opportunity for the other entities in the group to utilise the new knowledge. It is for this reason that MMAL agrees with the proposition of Principle 1, specifically, that the location of ownership of the resulting IP should not be relevant in accessing the future R&D tax incentive scheme.

With regards to question 1, conduct of R&D in Australia, MMAL understands and supports the current R&D tax concession legislation to specifically support R&D conducted in Australia. While MMAL supports the current 10% cap, we do believe there should be a greater threshold for overseas expenditure where it is for the purpose of an Australian based R&D project. Additionally, MMAL does not agree with the requirement to lodge a request to claim these activities and costs.

MMAL would propose that the overseas activities are brought into line with the self-assessment methodology. Allowing overseas activities to be more easily claimed in Australian projects would increase the potential for MMAL to engage in additional R&D activities.

In conclusion, MMAL could increase future R&D projects by:

- Undertaking additional R&D overseas; and
- Bringing more R&D to Australia without restrictions on IP ownership remaining in then Australian entity.

## **Principle 2**

*The standard R&D Tax Credit will be available at a rate of 40 per cent for eligible R&D expenditure and can be carried forward where a company's income tax liability is zero.*

MMAL fully supports the proposed 40 percent tax credit regime and the increased benefit it provides to companies performing eligible R&D in comparison to the current tax concession scheme.

Combined with the Principle 1, MMAL believes that increasing the after tax benefit to 10% may increase the level of R&D conducted in Australia from other countries with the corporate group.

## **Principle 3**

*The refundable R&D Tax Credit will be available to companies with a turnover of less than \$20 million at a rate of 45 per cent for eligible R&D expenditure.*

MMAL believes the entire value chain within the Australian innovation community must benefit from the introduction of the proposed R&D Tax Credit scheme. The 45 percent tax credit will allow MMAL's counterparts in the small to medium-sized enterprise category to obtain a superior benefit which will provide an increased incentive for these companies to grow and conduct further R&D to remain competitive in the Australian market.

Questions 2 and 3 raised under Principle 3 are answered in Principle 4 below.

## **Principle 4**

*Legislation for the new R&D tax incentive will provide support for the scheme's efficient and effective administration.*

MMAL supports the principle of effective administrative activities especially those relating to maintaining a clear delineation of roles and responsibilities between those bodies but with appropriate levels of co-ordination. It is imperative that the increased guidance by appropriately specialised and qualified personnel provides certainty to claimants on a continuous and timely basis.

MMAL has however, concerns relating to the compliance measures that would be required and undertaken by administrative authorities for distinguishing between core and supporting activities. This is discussed further under Principle 7 which explicitly relates to core and supporting activities.

Questions 2 and 3 concern MMAL due to the increase in administrative costs they would generate. While we agree that on the surface there is no net benefit to having non-enhanced costs within an R&D claim, it is administratively simpler to retain all R&D costs within the

same system. For example, a feedstock calculation may result in costs being included in the enhanced and non-enhanced provisions, treating costs from a single account differently in the tax return is not a simple exercise.

With regards to payments to associates, MMAL would discourage including the need to claim costs based on cash instead of accrual approach. Significant administrative time would be required to assess individual invoices within the corporate group.

We also consider the need to determine whether non-enhanced expenditure where the expenditure may not be otherwise deductible also requires an additional layer of administration.

## **Principle 5**

*The new R&D tax incentive should target R&D that:*

- (a) is in addition to what otherwise would have occurred; and*
- (b) provides spillovers – benefits that are shared by other firms and the community – that are large relative to the associated subsidy.*

During the Perth consultation session it was stated by the panel that there will be no requirement for a claiming company to identify additionality or spill over benefits. We request that this is made explicit in the new legislation. If the legislation is not explicit we are concerned that future audit activity could conclude that these requirements must be displayed at a company level rather than at a macro level.

We would also at this point like to raise the concern that large companies are being negatively targeted in this process compared to SMEs. We agree that a greater tax benefit at the SME level is a good policy objective, however this should not be at the expense of the larger companies. In consideration of spill over benefits, it would seem illogical to not support the large projects as they provide significantly greater short term economic benefits to Australia.

For example, an R&D project that we would undertake to develop the next generation mill for mining companies will cost in excess of \$10 million. During this project we will involve a large number of SMEs to provide services and parts. Further, due to our existing client base and international experience, the opportunity to commercialise the technology if its successful is relatively high.

Therefore, during this project we risk significant financial losses due to technical challenges, however we support a large portion of the community undertaking the project. If the project is successful the financial gains for SMEs and Australia will be significant.

Given the globalisation of our group, if the R&D support is not available to MMAL as in Principle 1 and 2, then less R&D is likely to be undertaken from our group in Australia.

## **Principle 6**

*Eligible R&D activity will be defined as systematic, investigative and experimental activity that:*

- (a) involves both innovation and high levels of technical risk; and*
- (b) is for the purpose of producing new knowledge or improvements.*

MMAL believes that the practicalities of satisfying a proposed dual criteria test must be carefully assessed from a commercial stance. MMAL is a representation of a multitude of styles of R&D projects and activities ranging from incremental R&D based on existing technologies, and investing R&D resources into both green-fields and blue-sky innovations and technologies. There must exist an appropriate level of tolerance for the applicability of incremental R&D

MMAL does not believe that the examples and discussions presented in the Paper are a true representation of the global approach to R&D best practice. The conclusion that the AND test must be introduced into Australia does not align with any practical application of R&D that we are aware of.

Another concern with Principle 6 is the introduction of the AND test in “activity”. Our interpretation of “activity” is a plural rather than singular, however an audit approach maybe to apply the AND test in a specific activity. Whether or not this is the intention of Principle 6 this would act as a significant detriment to Australian R&D:

- unless the legislation is supported by very detailed guidelines it will deter otherwise good opportunities from being conducted in Australia due to the uncertainty in what the legislation means; or
- if you do intend to introduce the AND test at activity level, it is very difficult to realistically show that an activity is both innovative and technically risky, for example design is not risky but produces an innovative solution and prototype testing is not innovative but displays risk in technical outcome.

## **Principle 7**

*Supporting R&D will continue to be recognised under the new R&D tax incentive but claims will be subject to new limitations.*

MMAL holds particular concerns to ‘tightening’ of the definition to increase the limitation of support activities as it could substantially reduce the amount of R&D projects that MMAL undertakes.

The nature and definition of R&D requires that the innovation or high levels of technical uncertainty be resolved. MMAL undertakes “lab” based projects as well as “real world” projects. While the technical objectives of the projects differ the process of determining a technical outcome require the same level of technical methodology. If a project requires production trialing to assess the technical outcome, then the production trialing is part of the R&D. Placing arbitrary barriers on it as core or supporting does not change the fact that the trial was a necessary part of the project.

Isolating costs and treating them differently depending on core or supporting definitions will be almost impossible to administer internally for a company and definitely not possible from a Government level to determine that each company applies the same criteria. It is not possible to develop guidelines for every type of project, technology or industry to determine what is core and what is supporting.

MMAL believes that R&D should be treated as a project not an activity. If an activity was required to deliver the technical input or outcomes of a project then it should be eligible. Placing boundaries around what parts of R&D can be claimed will potentially encourage less efficient R&D in Australia.

For example, making market research ineligible for the enhanced benefit, may reduce the amount of important background research a company can or should undertake to identify its technical objectives in line with the commercial opportunities. At the completion of a project, if trialing is not fully supported companies may be encouraged to be more wasteful and not seek even a token client payment if it will adversely impact the R&D (consider an SME receiving 45% cash back and selling a loss prototype, will they be less inclined to make small levels of income if it negatively impacts on their cash position).

Finally, managing costs at the activity level will be exceptionally difficult and very hard to administer.

The proposed restrictions will only serve to disenchant MMAL from undertaking R&D activities where the ability to claim support activities has been extinguished. As explained above, the support activities are critical for the commencement and continuation of an R&D

project and are often carried on to develop technical knowledge and technical options for a particular project.

By treating supporting activities in a different reference frame to core activities, there is a significant compliance risk and encumbrance on companies such as MMAL with regards to identifying and tracking R&D activities and costs in greater detail. Placing limitations on supporting activities would be legislatively challenging and it would be extremely difficult to make changes within this part of the legislation in any of the methodologies suggested without incurring significant negative impacts on a variety of the positive aspects of the R&D tax incentive scheme.

The requirement to register activities results in many claims where activities can be both of a core and supporting nature. This simple scenario makes every question raised in the Consultation Paper in respect of Principle 7, virtually impossible to implement.