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

Submission in response to the Government's Consultation Paper on the new research and development (R&D) tax incentive

Stahmann Farms Enterprises (Stahmann Farms) is pleased to have the opportunity to comment on the proposals put forward by Government regarding the new R&D tax incentive.

Who we are

Stahmann Farms is a supplier of tree nut product, namely Pecan and Macadamia. Initially set up by Deane Stahmann Jnr from the US, Stahmann Farms was purchased by Matthew Durack and Jeff Dodd in March 2008 and became an Australian incorporated entity.

We have a vertically integrated operation and manage everything from the farming and harvesting of Pecans, processing of Pecans, Macadamias and Walnuts, and packaging either as a stand alone product, or in a value add product (such as flavoured nut snack products). Based in Toowoomba and with farming operations at Moree and Gatton, we are a significant regional employer with over 100 staff and turnover of around $17 million. Our primary market is the Australian domestic market with a growing amount of product exported to the US, Asia and Europe.

Importance of R&D to Stahmann Farms

As a vertically integrated operation, we are proactively investigating and developing methods and technologies to increase the productivity, reduce costs, and develop environmentally sustainable practices. On the farm, we are undertaking considerable R&D into improving the yield and harvest of our Pecan crop as well as reducing the water usage and impact of the farm on the surrounding environment. In the factory, we have been undertaking R&D into improving the cracking process for Pecan and Macadamia nuts in order to increase the yield of whole nuts as these are commercially more valuable than pieces. We are also starting to develop our own range of value add products such as snacks and desserts. R&D is a necessity for Stahmann Farms; as a small player in the global Pecan and Macadamia industry we need to develop smarter and more cost efficient ways of producing our products. Further, as a farmer, growing environmental issues are of concern to us and a key focus of our R&D.

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The potential impact of the proposed new R&D tax incentive

We applaud the Government's stated intent of increasing R&D benefits to SMEs. Specifically, we support the increased rates of benefits to a 45% tax credit for companies under $20m turnover.

Our business revenues are influenced by a 2-year Pecan yield cycle - a high yield year, followed by a low yield year. Therefore the ability to receive a predicable cash payment for excess credits is particularly beneficial during our low yield years when cash flow becomes an issue and investment in R&D tends to stagnate because of this.

However, our concern is that any potentially additional benefit from an increase in the rate of benefit will be negated by the other proposed changes. In particular, our concerns are around principles 6 and 7 in the consultation paper. These may adversely affect our ability to gain the benefit of the R&D tax incentive. We believe this may be an impact unanticipated by Government, as Stahmann Farms is an SME undertaking important R&D both directed to critical environmental issues (like water usage in farming) and also at remaining competitive against large foreign players (allowing us to continue to be a regional employer, creating spillovers for rural Queensland).

The proposed changes to the definition of R&D activities to have both innovation and high levels of technical risk, in our opinion, will impact a number of small to medium sized businesses such as Stahmann. As a producer and supplier of nut product, we do undertake innovative activities that lead to new products and processes. However, we are not a net-producer of technology, and the majority of our R&D activities are undertaken to resolve technical uncertainty and risk around new and improved processes. We are unlikely to invent a revolutionary new nut cracking machine, however, the improvements we make are nevertheless technically risky and a critical part of the continuous improvements that allow us to remain competitive as an SME.

A move away from the current definition to include both innovation and high levels of technical risk will result in small to medium sized businesses such as Stahmann Farms will have a very limited range of activities that will attract the incentive. Thus there will be no tax incentive for us to continue to invest in ways to improve our operations. We would urge that the definition of R&D activities be kept consistent with current definition, and believe that the Government's desire to be cost neutral with regards to the new R&D tax incentive can be achieved through the removal of the 175 premium and international premium.

Of even greater concern to Stahmann Farms is the Government's proposal to limit supporting activities, primarily because:

i) All the proposals require companies to separately cost and identify core and supporting activities and this adds another layer of complexity and administration cost to companies. As our current business systems and practices do not consider this, we may need to make substantial changes in the way we undertake projects and record costs simply to access the R&D tax incentive. Needless to say this will act as a disincentive and will go against the Government's intent of making the R&D tax incentive easier to administer and targeted towards SMEs.

ii) Limiting the concessionary treatment of supporting activities will disadvantage the type of R&D typically conducted by Stahmann Farms. As an SME, we lack the infrastructure and resources to conduct R&D trials separately from the running of our operations. As such, to progress our R&D, we need to test and trial in the context of our operating activities. The limitations proposed will be detrimental to our claims.

We suspect disadvantaging an SME conducting R&D into important environmental issues and developing improvements to remain internationally competitive is not the Government's intent and perhaps an unforseen consequence of measures designed to curtail the claims of larger companies.

Conclusion

The increased rate of R&D incentive is certainly welcome, and for a company the size of Stahmann Farms, will factor in our decision making on future R&D projects. However, we feel that there are concerns that the changes in regards to the definition on R&D, and proposed restrictions on supporting activities, may have unintended consequences in reducing the overall level of R&D activities companies undertake due to:

i) Reducing the overall incentive to undertake R&D
ii) the additional administrative and compliance burden placed in satisfying the requirements of the changes.

It is for this reason we recommend that, specifically in regards to principles 6 and 7 that the current definitions of R&D activities be adopted for the new R&D tax incentive, and supporting activities continue to receive the full benefit of the R&D tax incentive.

Yours sincerely

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