



General Manager
Business Tax Division
The Treasury
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5th February, 2010

Dear General Manager of the Business Tax Division

Submission in response to Exposure Draft of the Tax Laws Amendment (Research and Development) Bill 2010, released 18 December 2009.

Please find herewith a submission by the Australian Dairy Products Federation on behalf of the dairy industry.

The Australian Dairy Products Federation (ADPF) is the dairy industry's peak policy body representing the nation's dairy manufacturers, processors and traders. The ADPF works closely with Australian Dairy Farmers, the peak body representing farmers, to develop and coordinate whole of industry policy and represent the industry on national and international issues.

ADPF welcomed the Government's initial intention for Research and Development (**R&D**) tax concession reform, recognising that R&D is necessary to promote economic growth and promote a highly skilled workforce. However, upon reviewing the exposure draft (**ED**) legislation, we are disappointed that many of the concerns raised in submissions lodged with Treasury in October 2009 have been ignored and that the ED in its current form will have negative implications for the Australian Dairy Industry.

In order for Australia's dairy industry to remain internationally competitive, innovative and sustainable, our members must continually undertake tasks which involve a substantial amount of technical risk with often unpredictable results in order to improve and redevelop breeding, farming and production processes and facilities.

Innovation in the dairy industry means a constant, incremental effort to improve both production and technical efficiencies in ways which have not until now been attempted or proven within the industry.

Without support from Government for the constant search for better techniques and technologies to underpin the improvements and effectiveness of business generally, the dairy industry in this country would no doubt become less competitive on the global stage.

It is ADPF's view that the R&D measures proposed in the ED do not promote the same level of support and this will impact on our members' ability to continue to respond to additional competition from overseas farmers and producers.

A number of the proposed changes will impact on R&D costs able to be claimed by our members and it is considered that other manufacturing and agricultural sectors such as ours will also be in the same situation. Some of the areas where the proposed ED will impact upon our members R&D are set out below.

Tightening of definition of core R&D activities

The definition of core R&D activities has been tightened to require 'considerable novelty *and* high levels of technical risk'. This has replaced the current definition which only stipulates innovation *or* high levels of technical risk. The fact that novelty is now required from the outset may effectively exclude many operational R&D activities and only focus on risky isolated R&D. In addition, as much of the R&D activities undertaken by our members will involve incremental improvements stemming from process reviews, testing and then implementation, it is likely that the novelty aspect may not be satisfied as the incremental improvements may not when viewed in isolation, be novel.

Supporting R&D Activities

The proposed changes represent a major shift from the current policies on claiming supporting R&D activities under the R&D tax concession. Under the new regime, supporting activities will need to be undertaken for the dominant purpose of supporting the core R&D activities and will need to be isolated from other normal production activities in order to be claimed.

As many of our members complete their analysis, testing and implementation of R&D activities on existing production systems and equipment, requiring those costs relating directly to R&D to be separated from those related to production operations would be extremely difficult. It may deem that these costs are not eligible, and at a minimum would unnecessarily impose a significant compliance burden. The cost of developing and using purpose built model or pilot plant would be cost prohibitive, and so the changes will result in a reduction in R&D costs that can be claimed by our members.

Further, since a large portion of the industry operates under a cooperative model, the proposed changes will impact dairy farmer members of those cooperatives who are currently dealing with a very difficult market and financial situation. The proposed changes will have a significant impact on the inclination of cooperatives to invest in R&D particularly where members have immediate need for returns, which in many cases are critical for the survival of their farms. Thus, any decline in profitability has the potential to impact the many rural communities highly dependent on the dairy industry.

Augmented Feedstock Rules

Close to the farm, the proposed expanded feedstock rules will restrict the R&D costs available for the R&D incentive as it appears to reward failure rather than results, ie. If the feedstock product is sold then this needs to be offset against the entire cost of development.

This is contradictory to the whole purpose of the R&D tax incentive. It does not recognise the commercial benefits that are derived from R&D and will not reward the risk that our members face in undertaking R&D.

It is ADPF's view that the current feedstock rules are sufficient. Risk related costs such as testing, processing and analysis work should all form part of the R&D incentive regardless of whether any resulting product is sold.

It should be noted also that the income from the sale of such feedstock is taxable assessable income, so in many instances the R&D activities will result in a cash-inflow for the government.

Conclusion

The ED will, if finalised in its current form, impact upon R&D investment in Australia which will reduce productivity and skills in our workforce, and consequently, our international competitiveness. It does not meet Dairy Industry's expectations of the support which an R&D incentive should provide, particularly for a sector so dependent on international trade.

The proposed ED is restrictive in its application and isolates the eligible R&D to be solely for brand new products with new processes, and pure academic research with potentially little commercial opportunity. It also rewards failure - not results - and ultimately, does little to encourage research and innovation in Australia's difficult and highly competitive agricultural and dairy industries.

Yours sincerely

A handwritten signature in black ink, appearing to read 'P. Stahle'.

Dr Peter Stahle
Executive Director