



Boral Limited

Submission

New Research and Development Tax Incentive  
Exposure Draft Bill

5 February 2010

Submission to: General Manager Business Tax Division  
The Treasury  
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PARKES ACT 2600  
[rdtaxcredit@treasury.gov.au](mailto:rdtaxcredit@treasury.gov.au)

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## **Submission Information**

**Organisation:** Boral Limited

**Type of Organisation:** Manufacturer and supplier of Building Products and Construction Materials.

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## Executive Summary

1. Boral supports the provision of an R&D Incentive, however is concerned that the changes in definition will restrict the incentive's application.
2. The current proposal for change lacks clarity, will create an additional administrative burden, will detract from the objectives of improving productivity, supporting job creation and increasing international competitiveness, and has an unreasonable implementation timeframe. **Serious consideration should be given to deferring the start date of the new provisions.**
3. Boral is concerned that the Exposure Draft Bill limits the Government's support to 'research' activities only, and not 'development', albeit that *Business Expenditure on R&D* (BERD) within Australia is comprised of 62% experimental development and only 32% applied research (with remaining 6% relating to pure basic research)<sup>1</sup>.
4. The Exposure Draft Bill does not support large corporations such as Boral, who have a sustained track record of providing 'spillovers' through their ongoing contribution of innovative developments within Australia.
5. The Exposure Draft Bill should provide for grandfathering in respect of projects currently in progress and committed to prior to Treasury's release of the Consultative Paper regarding the proposed R&D Credit on 18 September 2009.
6. It doesn't appear that consideration was taken of the matters raised in Boral's submission provided during the consultation process in November 2009. Boral's earlier submission is attached in Appendix 1.
7. Boral encourages Treasury to take into account the matters raised in the earlier submission before implementing any changes to the current legislation

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<sup>1</sup> Australian Bureau of statistics, 2007-08 'Business Expenditure on R&D', 25 September 2009

## **Exposure Draft – Major Areas of Concern**

### **1. Definitional Change to Core R&D Activities**

#### **Component of Exposure Draft Bill:**

Tax Laws Amendment (Research and Development) Bill 2010  
Schedule 1, Subdivision 355 – B Meaning of R&D Activities and Other Terms (s355 – 25)

#### **Specific Areas of Concern:**

- *The inclusion of the ‘AND’ test in the definition will limit the type of projects which will be subject to Government support.*
- *The absence of a definition of ‘considerable novelty’ will increase the level of uncertainty for claimants and potentially create additional compliance costs.*
- *The definition requires an assessment of what technology is publicly available on a reasonably accessible worldwide basis thereby adding an additional level of uncertainty and increasing the cost of compliance*
- *The definition fails to recognise the practice of industry competition where technical information is not commercially available, nor reasonably accessible.*
- *The definition needs to recognise the complexity of process development and improvement in large industrial processes, and the relevance of unique variables of geographical, climatic and product features.*

#### **Recommendations:**

1. Boral recommends the removal of the proposed ‘AND’ test in relation to the eligibility of R&D and the maintenance of the current definitional test of ‘innovation OR high levels of technical risk’.

Under the current regime companies have demonstrated that considerable ‘spillovers’ are achieved where only one eligibility test is achieved.

2. Boral recommends the removal of the wording ‘considerable’ (in reference to novelty) to alleviate the introduction of a very subjective condition for which there is minimal guidance.

## **2. “Dominant” Purpose of Supporting Activities**

### **Component of Exposure Draft Bill:**

Tax Laws Amendment (Research and Development) Bill 2010  
Schedule 1, Subdivision 355 – B Meaning of R&D Activities and Other Terms (s355 – 35(1))

### **Specific Areas of Concern:**

- *The introduction of a dominant purpose test in place of an “a” purpose test.*
- *Potential increase in compliance costs to claimants*
- *Boral’s R&D developments require the conducting of trials in the field, as laboratory scale tests will not replicate field conditions and are not feasible. The dominant purpose test will exclude such trials.*

### **Recommendation:**

Boral recommends the repeal of the wording ‘dominant’ purpose and its replacement with “a purpose directly related to...”

### **3. Augmented Feedstock Provisions**

#### **Component of Exposure Draft Bill:**

Tax Laws Amendment (Research and Development) Bill 2010  
Schedule 1, Subdivision 355 – G Feedstock Adjustments (s355 – 450)

#### **Specific Areas of Concern:**

- *The proposed feedstock provisions are potentially to the detriment of companies seeking to validate their laboratory based research in a commercial operational environment*
- *The proposed feedstock provisions fails to recognise that business bears the financial risk in relation to its R&D and needs to undertake its activity in its own commercial environment*
- *Compensating and effectively only rewarding failure*
- *Practically, this is more akin to a clawback function as opposed to a feedstock mechanism*
- *Potentially companies will be unable to recover the compliance costs incurred, unless they can be passed on to the end consumer in the form of increased prices*

#### **Recommendation:**

Boral recommends that the list of quarantined R&D activities be broadened to include the labour and overhead items associated with the production of a feedstock output and are not subjected to a dominant purpose test.

## **4. Excluded Activities**

### **Component of Exposure Draft Bill:**

Tax Laws Amendment (Research and Development) Bill 2010  
Schedule 1, Subdivision 355 – B Meaning of R&D Activities and Other Terms (s355 – 35(2))

### **Specific Areas of Concern:**

- *The extended list of supporting activities has the potential to limit the quantum of a claim*
- *The potential changes fail to recognise the necessity to complete both research and development to bring innovation to fruition. The new rules will potentially reward only activity that is research based.*

### **Recommendation:**

Boral recommends the retention of the excluded activities list associated with current R&D tax concession regime.



## **5. Compliance & Administration**

The new incentive regime contained in the Exposure Draft Bill is viewed by Boral as being onerous and expensive to comply with, open to increased subjectivity and uncertainty, and potentially counterproductive in its aim of seeking to stimulate innovation across business in Australia.

Treasury is encouraged to give due consideration to Boral's previous submission to the Consultative Paper of September 2009 before any changes are enacted on the current R&D incentive regime.

## **Appendix 1 – Boral Submission to Consultative Paper (October 2009)**



Boral Limited

Submission

New Research and Development Tax Incentive

26 October 2009

Submission to: General Manager Business Tax Division  
The Treasury  
Langton Crescent  
PARKES ACT 2600  
[rdtaxcredit@treasury.gov.au](mailto:rdtaxcredit@treasury.gov.au)

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## Submission Information

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# **1. Introduction**

## **1.1 Executive Summary**

1. Boral supports the provision of an R&D tax incentive.
2. Boral supports the notion of broadening the base of applicants to promote innovation and investment, support jobs and strengthen Australian companies.
3. Any broadening of the base should not be at the expense of claims for existing legitimate research and development activity.
4. The existing R&D system provides Boral with incentives that result in significant spillover benefits into the broader community. The proposals as drafted in the Paper have the potential to remove, and/or reduce, these incentives and eliminate these spillover benefits.
5. Any broadening of the base should not be at the expense of larger corporations.
6. Activity that is innovative or involves high levels of technical risk which results in new knowledge or improvements should continue to be eligible for the incentive.
7. Larger corporations should not be restricted in accessing incentives because they may undertake the activity anyway. Incentives ensure that the activity is undertaken (particularly when projects are required to compete for scarce capital resources) and undertaken more quickly than might otherwise be the case.
8. Any concerns in respect of abuse to the system should be dealt with by proper and appropriate enforcement and/or specific legislative measures which are precise or able to be precisely applied.
9. The current proposals for change lack clarity and have the potential to create an additional administrative burden thereby detracting from the stated objectives and the incentives provided. In particular there should be no requirements to distinguish core and supporting activity, and any determination or quantification of spillover benefits is not practical, nor is it commercially feasible.
10. There is the need for transitional measures for projects which are currently in progress which benefit from the existing system.
11. Serious consideration should be given to deferring the start date until proper consideration is given to the concerns raised by the business community.

## 1.2 The New R&D Tax Incentive

In the May 2009 Federal Budget, the Government announced that it would replace the existing Research & Development (R&D) tax concession with a new R&D tax incentive in the form of an R&D tax credit applicable from the income years commencing on or after 1 July 2010.

During September 2009, the Department of Treasury (Treasury) released a consultative paper, “The new research and development tax incentive Consultation Paper September 2009” (the Paper) identifying some high-level principles that would guide the design and implementation of the new R&D tax incentive, and seeking feedback from affected and interested parties.

Boral welcomes the Government’s initiative in undertaking a comprehensive review of the R&D framework within Australia, the shaping of Australia’s approach to innovation, and how the incentive may be accessed by business.

As set out in the Paper the changes seek to provide a “...*more streamlined R&D tax incentive from July 2010 ...*”<sup>2</sup> that will “...*be more effective in delivering support for business R&D and in targeting that support to where it is most likely to produce net-benefits for the Australian community.*”<sup>3</sup>

Boral has concern that these objectives may not be achieved.

In summary, Boral’s key concerns lie in the proposed principles of:

- Principle 6 –** noting the potential significant constraint to claims should the definitional requirements specifically dictate “innovation **and** high levels of technical risk”;
- Principle 7 -** noting the potential significant limitations on the quantum of claimable supporting activities regardless of the nexus to a core activity and the administrative difficulty of segregating core and supporting activities; and
- Principle 5 -** noting the highly subjective proposal to incorporate an “additionality and spillovers” test within the legislation and the subjective nature of identifying such benefits.

These concerns for the impact on Boral’s industry are to be evaluated in the context of the potential to disadvantage established Australian based manufacturers who have broad involvement across the community in terms of employment and sustainability relative to smaller, newer businesses which may not have the same capacity to impact and sustain the Australian community.

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<sup>2</sup> The Paper, paragraph 1

<sup>3</sup> The Paper, paragraph 8

### **1.3 The Value of R&D**

Boral agrees that the Government plays an important role in shaping and supporting Australia's innovation activities.

The benefit derived by Boral from funds received through the R&D tax concession has enabled more projects to be undertaken at a faster rate of implementation, thus ensuring Boral remains competitive and continues to provide spillover benefits. The incentive funds enable people to be employed in, and engaged in, research and development activity. When that activity is successfully implemented there is better use of resources and technology, a reduction in the cost of product to the consumers, an increase in the range of product to the consumers, and a lesser impact on the environment.

With any business the magnitude of Boral, there will at any given time be a number of projects competing for available (but nonetheless finite) funds. The R&D tax incentive enables Boral's R&D projects to compete at an effective lower cost of capital. The importance of the cost offsetting contribution is of greater significance in the current market due to downward pressures on capital projects, and tight financial markets.

In the context of the global market, the Australian business of Boral has to date been able to compete against the threat of cheaper imports, particularly in terms of cement and plasterboard, being introduced in large volumes into the Australian marketplace. This ability to remain competitive is a direct result of R&D being embraced by the business, as Boral constantly seeks to innovate across its various streams of products and processes.

For Boral companies, R&D conducted on an operational level has translated to:

- The creation and introduction of a range of new products to a wide range of construction based markets;
- The introduction of new state of the art manufacturing facilities and a number of significant capital investment projects introducing new processing technologies;
- Job creation and job retention;
- Flow on effects for those industries supporting Boral businesses including contractors, consulting firms and a range of SMEs;
- Reduction on the costs of manufacturing; and
- Enhanced ability to compete against imported products through product innovation and process improvement.



## 2.0 Specific Comments

### 2.1 Comment on Principle 6

#### *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.*

#### **Response**

Boral is a mature business in many respects yet constantly seeks the advancement of its processing capability and its product offering. A proportion of its R&D would qualify under the current R&D Tax concession because of the nature of its technical risks, yet may not be eligible under the newly proposed definition as the activities may not be considered to be **both** innovative and have high levels of technical risk. This will however largely depend on how “innovation” will be defined in the draft legislation and more importantly, how it will be implemented at a practical assessment level.

#### ***Cement Kiln Example***

A relevant example of where a previously eligible R&D project under the existing framework has the potential to be rendered ineligible under the proposed changes is the recent process improvement of the Berrima cement kiln by one of our subsidiaries. Notwithstanding that the activities involved the application of equipment and change in process in a different operating environment to that which had been done anywhere previously; there is the possibility that the activities would not be regarded as innovative. There were however very high levels of technical risk involved in developing the cement process to allow for the increased capacity of the plant from 1 million tonnes per annum to 1.4 million tonnes.

The improved productivity delivered by the project enabled the business to respond to competition associated with lower priced imports which were entering the market at a rapid pace. Further the business was able to offer vastly superior products; both technically and in terms of quality, which were produced domestically under more strict environmental and safety protocols.

Producing cement with lower operating costs and more efficiently, offers spillover benefits to the community in the form of improved sustainability with lower consumption of energy and resources per unit.

As noted Boral’s work on new and improved products and processes involves incremental improvements that may not on their own be considered innovative and hence may not qualify under the proposed new eligibility requirements. However they do result in new knowledge and improvements in the Australian environment. In addition, there is a strong argument that Boral’s R&D creates substantial spillover benefits. Some of these relate to new and improved raw materials for roads, and higher strength and lightweight concretes. The use of these improved materials which resulted from Boral’s R&D activities, allows the possibilities of longer lasting and improved quality roads and infrastructure and buildings being built with less internal support columns and larger floor spans.

To change the definition to include “innovation and technical risk” has the potential to render some activity ineligible that provides new knowledge and improvements, as well as very large spillover benefits to the community.

#### **Recommendation**

Boral recommends that the current definition of eligible R&D activity be maintained, i.e. defined by innovation or high levels of technical risk. The definition of what constitutes eligible R&D is well understood and widely accepted. Any perceived abuses to the operation of the system can and should be dealt with via the existing review channels specifically provided for in the legislation to both the ATO and AusIndustry. Altering the definition to that suggested in Principle 6 will not encourage R&D within Australia but will have the more likely impact of contracting the scope of R&D undertaken in a manufacturing environment.

## 2.2 Comment on Principle 7

### *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.*

### **Response**

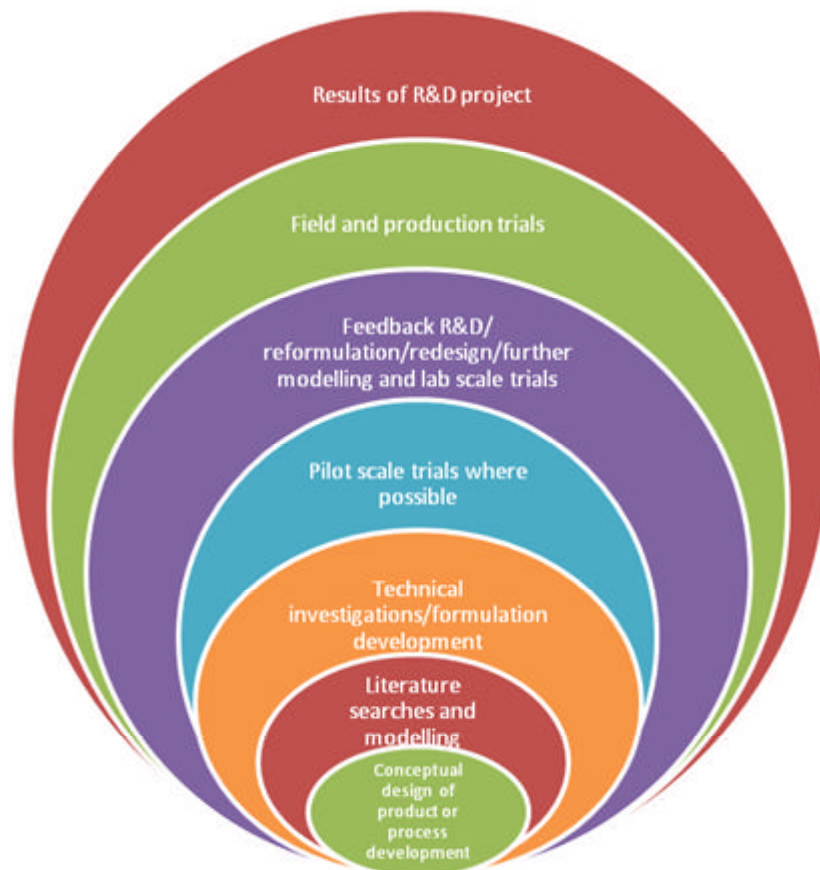
Treasury's confirmation that supporting R&D will continue to be recognised under the new R&D tax incentive is commended by Boral. However Boral has serious concerns in relation to the extent of the new limitations which may be introduced. There is a strong nexus between both core R&D activities and R&D supporting activities. Limiting the claiming of supporting R&D activities may hinder the progress of Boral's R&D projects.

Boral as a business must continuously innovate and evolve. In order to do this, ideas for improved products and processes must be conceptualised and modelled before being developed through to a technical testing phase. Further, the results achieved in the testing must be extrapolated into field trials and later scaled up to production.

Each project or activity, whether it be for product development or process improvement, requires a combination of core and supporting activities. To limit the eligibility of one, would create a program which recognises only partial R&D. In fact limiting supporting activities has the potential consequence of limiting the project to that of research alone, with limited development. Boral undertakes both research **and development**. Its projects are not limited to activities which are simply scientific and/or experimental in nature. The activities must be capable of being scaled up to allow for the development of commercial, reliable and sustainable products and processes. Such activities to date have been supported by the R&D tax concession which has been developed as an industrial R&D tax program and not a purely scientific one. Limiting supporting activities may reduce the scope and effectiveness of the new tax incentive and its role as a funding mechanism incentivising R&D within Australia.

The business uptake and utilisation of the existing R&D tax concession regime to date has assisted Boral to bring forward key projects which have significant spillover effects in the community. Limiting funding for eligible supporting R&D activities under the proposed operation of the new R&D tax credit may significantly hinder Boral's ability to continue its projects to the extent, and within the timeframes at which, currently undertaking.

The elements of a successful R&D project for Boral are highlighted in the diagram below. In particular, Boral notes that the span of activities necessarily includes a combination of core and supporting activities.



**Figure 1: Boral's R&D activities**

### ***The importance of supporting activities***

Any R&D project requires a combination of both core and supporting activities.

#### ***Theoretical to Production***

There is a quantum leap in taking a theoretical model and concept, and ultimately moving it into production to allow for the manufacture of a viable product, or undertake process improvement.

Results achieved in the experimentation phase may not readily translate into the manufacturing process or finished product. There are still significant efforts required and substantial technical risks to be mitigated in order to take the tested concept and apply it commercially.

By way of example, creation of a new formulation for plasterboard, aggregate or concrete mix may commence within a laboratory environment. The ability to produce such a formulation within the confines of the production processes operated by Boral requires additional core and supporting R&D activities to develop the appropriate process flows and operating conditions, as well as the further development of the formulation in response to such variables. It is essential to recognise the total project, rather than confine it to the early stages of the R&D.

Further environmental impacts and operational wear and tear on machinery can rarely be modelled, leaving significant unknowns as to how the research output will translate and behave when actually introduced. For example the mixing of a new high-strength (Mpa) concrete conceptualised and developed in the laboratory, may fail in the field if Boral is unable to deliver a product exhibiting the same characteristics to the site in terms of the appropriate flowability, pumpability, cure-time and strength. Environmental issues such as temperature and humidity can also have a major impact on the ability to produce a product in a full scale operation, in contrast to that found in a laboratory. These parameters cannot be simulated within a laboratory or technical centre on the scale which can arise

within the field. As a result, it is a necessary requirement to prove the formulations and processes in the production environment through the undertaking of both core and supporting activities.

A significant amount of R&D time is expended completing field trials and ongoing reliance is placed on ensuring that products performing in the field truly exhibit the desired parameters and operational characteristics conceptualised in the experimental phase. Such supporting activities are crucial to the success of the project.

#### *Pilot Plant to Production*

Taking a conceptual idea to production is a significant challenge when reflecting on the nature and size of the projects embarked upon by Boral.

Boral utilises pilot plant facilities where it is commercially viable to do so. However it is not normally commercially viable to construct an R&D pilot plant in parallel to a production plant. Further from a commercial perspective access to the full scale production facilities is a requirement of any R&D project undertaken by an organisation such as Boral. Supporting activities in the form of both pilot and full scale trials are a necessary and key component of Boral's R&D projects.

#### **Recommendation**

Boral recommends that the operation of the proposed new R&D tax incentive continue to allow for the inclusion of all supporting eligible R&D activities as part of any claim. The approach adopted under the current definition of R&D tax concession has been seen to be effective in encouraging and supporting R&D.

In order to address any major revenue leakage concerns, we are in support of the conduct of increased audit activity and monitoring where it may be perceived by Treasury that certain industry claimants and/or activities are seen as inconsistent with the intent of the R&D tax incentive. This would result in the more effective constraint of the questionable claimant whilst delivering to the Government's objectives.

## 2.3 Comment on Question 4

### Question 4

*Should supporting activities:*

- (a) *be capped as a proportion of expenditure on core R&D?*  
*(i) If so, what would be the appropriate proportion (for example, 1:1)?*
- (b) *only be eligible where they are for the sole purpose of supporting core R&D activity?*
- (c) *exclude production activities or dual role activities?*
- (d) *only be eligible on a net expenditure basis?*
- (e) *attract a lower rate of assistance than core R&D?*

### Response

As discussed above, the role of supporting R&D is fundamental to the validation of any theoretical or conceptual ideas and their natural progression from testing field trials and ultimately production.

Boral's response to each of the five options presented within the Paper is set out below, and should be read in the context of the comments regarding Principle 7 noted at 2.2 above:

#### (a) *Capped as a proportion of expenditure on core R&D*

The view expressed by Treasury that “...*the amount of supporting activity being subsidised is also a significant part of the cost of a related commercial activity...*”<sup>4</sup> is relevant. It is also a reflection of the necessary activities which comprise R&D projects undertaken by corporate Australia. Supporting R&D activities make up a valuable portion of R&D and therefore a blanket cap could be detrimental to the delivery of many projects across a number of industry sectors.

Developing a completely new product or process can involve a higher level of capital investment and R&D spend than if the R&D was confined to the carrying out of improvements to existing products and processes. Over the years, Boral has made significant capital investments in introducing both new products and new processing technologies to its operations. A cap imposes an artificial boundary for industries which are capital intensive and rely heavily on the conduct of production based trials to prove their R&D. The proposed cap also relies on companies distinguishing between core and supporting activities to which we strongly disagree, on the grounds of administrative complexity.

Boral is not in support of limiting the extent of directly related supporting activities (as outlined in Comment 2.2 above), albeit there may be a tax revenue basis to cap such supporting expenditure.

#### (b) *Only eligible where they are for the sole purpose of supporting core R&D activity*

The introduction of a sole purpose test fails to recognise the requirement for companies to undertake R&D within a production environment. Boral does not operate a separate R&D facility which replicates full scale activities. There is a valid need to undertake field and production trials in the operating environment. Boral's R&D activities relate to the development of new or improved products and processes. In order to validate them, testing and trialling must be undertaken within the normal production environment.

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<sup>4</sup> Paragraph 57, The Paper

The current R&D tax concession has operated in the context of a fully functioning business environment and has not been limited to the situation where R&D is undertaken in isolation. The program has been realistic in recognising the context of R&D within this environment and as a result, has allowed for the furthering of R&D activities within Australia.

Limiting supporting activities to those which are *only eligible where they are for the sole purpose of supporting core R&D activity*, will limit the effectiveness and applicability of the new R&D tax incentive.

(c) *Exclude production activities or dual purpose activities*

Boral's discussion with reference to Comment 2.2 above outlines the rationale regarding the necessity to undertake R&D activities in a production environment. Boral does not support the proposed methodology which would *exclude production activities or dual purpose activities* from being eligible supporting R&D activities. Not only would it be detrimental to the pursuit of Boral's R&D projects, but it would also adversely impact on all businesses within the Australian manufacturing sector.

To pursue such a limiting methodology would be detrimental to the majority of claims in manufacturing industries where innovation is being constantly sought, and teams are being challenged with projects involving high levels of technical risk. Such projects are undertaken simultaneously with the manufacture of product, potentially with some product being unsaleable.

(d) *Only be eligible on a net expenditure basis*

A net expenditure basis introduces an additional level of compliance and complexity which detracts from the incentive. Boral does not operate suitable systems which could effectively isolate R&D supporting expenditure, which could then be offset against any benefit resulting from the related R&D. The inclusion of this option would make the concession unworkable. It also detracts from a policy objective of the new tax incentive which is to be *more effective in delivering support for business R&D*.

(e) *Attract a lower rate of assistance than core R&D*

Boral is not in favour of this proposed methodology for the reasons that, it again relies on the separation of core and supporting activities and, if successful, would devalue the importance and effort expended on supporting activities.

A two tier program will not be "*more effective in delivering support for business R&D and in targeting that support to where it is most likely to produce net-benefits for the Australian community*". Boral's submission has illustrated the many net-benefits which are created as a result of our R&D. These benefits result from the comprehensive R&D projects which are undertaken, and which necessarily involve both core and supporting activities. A lower rate of assistance for supporting activities will introduce further compliance costs in regard to additional calculations for R&D support, and different record keeping systems to isolate core and supporting expenditure.

## **Recommendation**

Boral recognises that the proposed policy aims to increase the number of claimants over a four year period, yet remain "...revenue neutral"<sup>5</sup> for the same period. Boral further understands that Treasury is seeking options to secure this outcome. Boral suggests that attention should be focussed on proper enforcement and application of the existing provisions, rather than limiting the claim for supporting expenditure.

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<sup>5</sup> The Paper, paragraph 14

## 2.4 Comment on Principle 5

### *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.*

### **Response**

In developing an incentive proposal Boral views it as unnecessary to include, either as an intended purpose of the proposed legislation, or within the legislation itself, the objective that the R&D tax incentive should target R&D that is in addition to what otherwise would have occurred.

“Additionality” is not a principal which should form a part of the intended policy relevant to the new tax incentive. Its concept is highly subjective and will cause difficulties in assessing whether R&D factually arose as a result of the new project which would not have been undertaken but for the incentive, or would have been undertaken anyway.

It is likely that significant effort will be required to assess the principal of additionality in relation to all future claims under the new incentive. This would detract from the ease of application of the tax incentive, increase compliance and regulatory costs and could curtail R&D in Australia. All being contrary to what is intended.

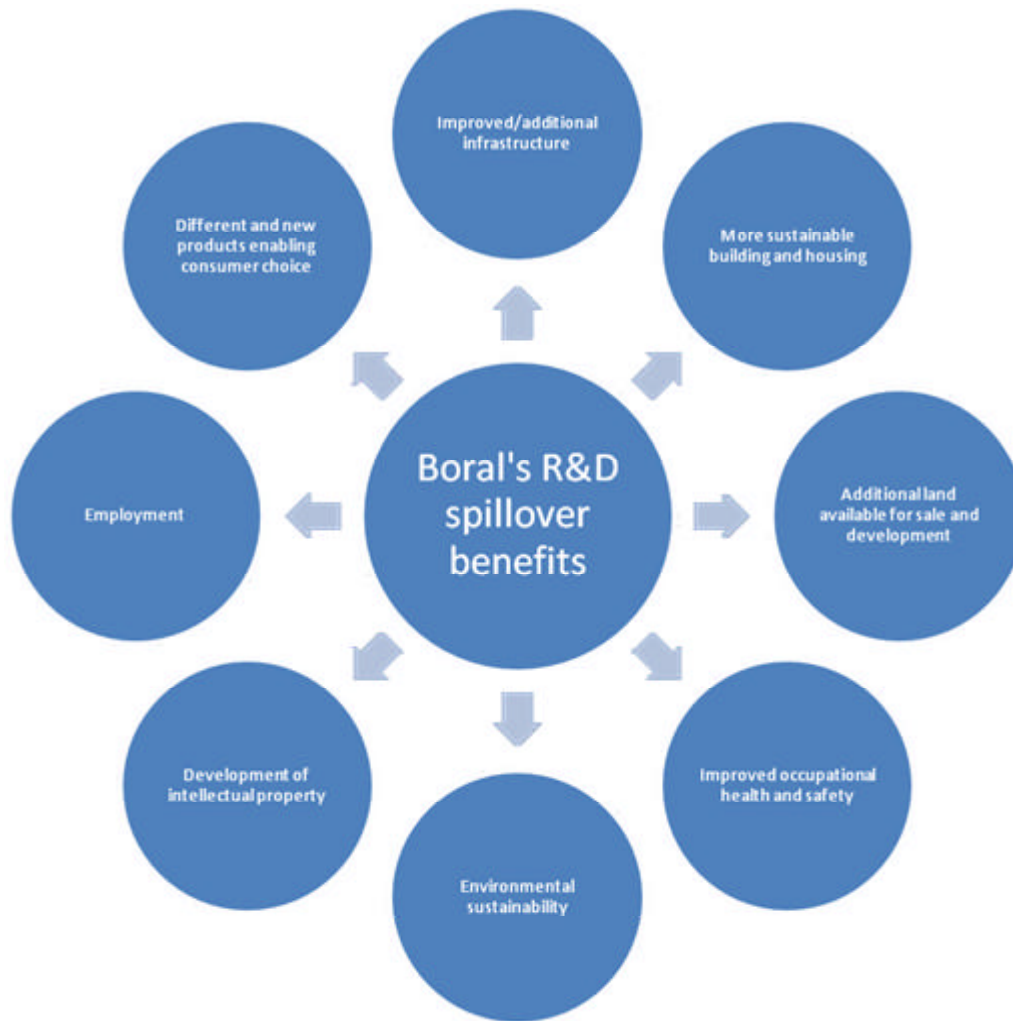
Boards, investors and management are reluctant to approve and undertake projects with inherent uncertainty, particularly in the current economic downturn. In today’s economic climate it is unlikely that many R&D projects will be undertaken unless companies have a “more certain than not” expectation that there will be a reasonable rate of return, in terms of sales of new or improved products or services, or in terms of improved productivity or efficiency. Boral suggests that most projects would not proceed if the only factor making a project financially viable was the receipt of an R&D tax benefit. This is compounded by the fact that the benefit of the R&D tax mechanism is received well after expenditure is incurred.

Although it could be argued that some of Boral’s R&D activity would have occurred without a tax incentive, it must be noted that the current R&D Tax Concession enables the benefits of Boral’s entire R&D effort to be realised much more rapidly. This is important for a number of reasons including:

- Providing R&D spillover benefits to the community more rapidly;
- Employment; and
- Environmental sustainability.

Boral’s R&D effort provides spillovers to other businesses and the community in many forms. The diagram below identifies the major spillovers which result from the undertaking of R&D activities by Boral. Boral’s R&D projects do not result in internal benefits alone. The impact of the R&D spillover benefits are significant and provide direct benefits to the community on an ongoing basis. The size of these spillover benefits are anticipated as large relative to the funding received from the R&D tax concession. However the major issue is how are they to be measured relative to the incentive received. As detailed below there is no doubt spillover occurs and it can be asserted that it is large but it is not readily quantifiable. As such, serious consideration should be given to removing this requirement as drafted in the Paper.





**Figure 2 Spillover benefits stemming from Boral's R&D**

Importantly, in relation to paragraph 50 of the Paper, we do not believe the system should penalise large businesses in favour of small and medium enterprises when the spillover benefits of R&D conducted by large companies are large relative to the subsidy. Smaller firms often have less flexibility and internal R&D capacity to respond quickly to new areas of R&D and to solve problems quickly.

*Providing R&D spillover benefits to the Australian community more rapidly*

The R&D tax concession and the new R&D tax incentive can assist Boral with advancing spillover benefits more rapidly. The speed at which Boral is able to innovate influences the speed at which spillover benefits are available to the community and other businesses. Boral supplies the construction markets through the provision of cement, aggregate and gypsum, and products such as concrete, asphalt, timber and plasterboard. By rapidly implementing R&D, Boral is able to provide new and improved products to stimulate improvement and change in construction designs, methodologies and material usage.

*Employment*

- Encouraging and rewarding R&D efforts is vital to growing and sustaining the sizeable workforce employed by Boral. Such is the importance of R&D that it is taken into account in performance monitoring of businesses within the Boral group of companies.

- Boral is a large employer with around 10,000 employees across approximately 600 sites within Australia. A significant number are employed directly in R&D activity via Boral's network of laboratories and technical centres or directly involved in specific R&D projects, importantly jobs are able to be maintained in Australia as a result of product and process innovation.
- In addition, Boral engaged approximately 5,700 contractors in 2008/09 in Australia.

#### *Environmental Sustainability*

**An Environmentally Sustainable Australia** is one of the Federal Governments four National Research Priorities (NRP's). A high proportion of Boral's R&D directly addresses this need for sustainability arising from Government pressure and market demand. Some examples include:

- The use of recycled waste products:
  - Boral has developed crushing methodologies and concrete mix designs to enable concrete waste from demolition to be recycled and subsequently reused in new concrete. This diverts waste away from landfill and is a key component of structures built under the Green Star environmental rating system.
  - Boral has developed the use of increasing proportions of recycled asphalt into new asphalt products again diverting waste from landfill and helping their clients meet sustainability targets by providing products made from recycled materials and reducing the pressure on virgin resources.
  - A proportion of glass collected for recycling cannot be used. This proportion is generally ground up and disposed in landfill. Boral has been able to develop new and innovative asphalt products that utilise this crushed glass in place of sand.
- Development of alternative products to prolong the useful life of natural resources. In addition to utilising recycled raw materials, Boral has also expended significant R&D effort on developing ways to optimise the use of natural resources:
  - Boral has focussed significant R&D efforts towards the development of manufactured sands that can be substituted for natural sands. Boral has also invested in R&D to determine methods to utilise quarry dust in place of natural sand. Both of these strategies help to reduce the pressure on reserves of natural sand whilst maintaining a competitive supply of quality raw materials to industry.
  - By developing innovative ways to utilise waste materials from the quarrying process, Boral seeks to extend the useful life and productivity of existing quarries.
- More efficient use of raw materials (including water):
  - Boral continuously undertakes R&D to achieve improvements in the efficiency of raw material use and to reduce the consumption to portable mains water in manufacturing and associated activities.

It would seem somewhat contradictory for the Government to encourage "an environmentally sustainable Australia" but then tighten the eligibility requirements for R&D tax incentives, such that activities similar to those set out above could be denied benefits.

#### **Recommendation**

We recommend that the proposed legislation does not include an 'additionality and spillovers' test as this would add significant complexity and subjectivity to any claim at a time when business is looking for simplification and certainty.

## 2.5 Comment on Principle 4

### ***Principle 4***

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

### **Response**

Boral supports a legislative framework that provides for the scheme's efficient and effective administration.

However, Boral's initial interpretation of the underlying principles of the new tax incentive, as presented within the Paper, highlights a significantly increased level of future complexity. Such complexity would ultimately encumber claimants with further additional administration beyond that which is required of the existing R&D tax concession regime. The proposed operation of the new tax incentive will not provide for more efficient and effective administration.

There are several areas identified in the Paper which will pose an administration burden to any potential claimant, with the main ones being:

- 1) additional requirements which “...*distinguish between core and supporting activities...*”<sup>6</sup> and their related expenditure;
- 2) The application of an “...*additionality and spillovers' test...*”<sup>7</sup>

Under the current R&D tax concession the absence of a requirement to separate ‘core’ and ‘supporting’ activities is aligned with available data capture and accounting systems. To seek the splitting of ‘core’ and ‘supporting’ activities and ensure the technical documentation and associated financial information reflects such, will introduce a level of reporting which does not correspond with most businesses’ accounting and record keeping systems. Information technology systems and financial accounting packages currently available do not have the capacity to capture and manipulate financial data to reflect an ‘R&D’ or ‘production’ status and then further a split between being ‘core’ or ‘supporting’ activities. Certainly Boral does not operate systems which would readily reflect such requirements. The R&D tax incentive will be accessed by many businesses of Boral, which have varied record keeping system and undertake varied R&D projects. The compliance with such requirements will create a significant cost to Boral across its business.

The additional cost to business to adapt, modify or purchase information and financial systems that would accommodate such a significant change would be extremely onerous and possibly prohibitive.

It is disconcerting that the additional level of complexity and subsequent administration will in fact be contrary to that which is contemplated; where the simplification to any administration was paramount.

### **Recommendation**

Boral suggests that any move to the proposed new R&D tax incentive does not further increase the compliance complexity. To this end, any proposal to differentiate expenditure between “core” and “supporting” activities should not be pursued.

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<sup>6</sup> The Paper, paragraph 47

<sup>7</sup> The Paper, paragraph 48

## 2.6 Comment on Question 6 – Software R&D

### *Question 6*

*How should the new R&D tax incentive treat software R&D?*

### **Recommendation**

Boral recommends that the ‘multiple sales test’ for software R&D be excluded to allow for the inclusion of eligible expenditure where it forms part of a supporting activity with a nexus to a core R&D activity.

## 2.7 Comment on Transitional Issues

It should be noted that whilst Treasury has put in place a clearly defined starting point for the new R&D tax incentive, being “...*from 1 July 2010.*”<sup>8</sup>, there remains significant perceived operational issues in the transition between the existing R&D tax concession and that of the proposed R&D tax credit.

According to the Paper, the Exposure Draft legislation is planned to be available for comment later this year. Once the comments have been reviewed and their merits discussed it is planned that the relevant legislation will be introduced to Parliament in early 2010. Assuming the legislation is passed without further amendments, this would practically allow companies a time frame of less than three months prior to 1 July 2010 to fully consider and implement the new scheme. Based on the design principles outlined in the Paper, it is expected that there will be a great deal of uncertainty surrounding the practical implementation of the new scheme and for complex businesses such as Boral this timeframe is likely to be impractical.

The question also arises as to how projects that are currently registered under the current R&D tax concession will be dealt with when they continue after the new R&D tax incentive has been introduced.

Specifically, the current R&D tax concession seeks registration of activities on a per project basis whereas the proposed R&D tax incentive looks to individual R&D activities. With the proposed amendments to the registration of projects/activities and what constitutes eligible R&D, there is added uncertainty as to continued project eligibility during the transition and access to corresponding R&D funding.

In addition, there may be instances where the innovation or core R&D activities have occurred in a prior period and the company is now undertaking ongoing supporting activities in a subsequent year. These activities undertaken in subsequent years do not contain innovation but are nevertheless integral and necessary to validate its original technical hypothesis. This is not unusual in the context of companies undertaking large commercial projects that are a combination of both experimental and applied industrial development and are carried out over a number of years.

Boral has a number of ongoing projects that will be impacted if transitional provisions are not properly considered.

### **Recommendation**

Boral suggests that eligible projects which have been registered prior to the commencement of the new tax R&D tax credit under the current R&D tax concession (and their constituent activities) continue as eligible in their entirety under any transition to the proposed R&D tax incentive. We further suggest that the activities remain eligible until the cessation of the previously registered R&D project.

In addition, Boral suggests that the operative date be deferred until such time as the issues raised are properly considered and addressed.

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<sup>8</sup> The Paper, paragraph 1

### **3.0 Conclusion**

Boral is deeply committed to the conduct of R&D across our businesses.

Boral thanks Treasury for the opportunity to submit a response to the Paper and we are pleased to provide our feedback and comments in relation to the proposed New Research and Development Tax Incentive for its consideration.

Boral welcomes the opportunity to meet with Treasury to assist with the further understanding and clarification of any comments and feedback expressed herein.

## **Appendix - Boral Limited Group of Companies**

Boral is the largest building and construction materials supplier in Australia, and has significant operations in the USA and in Asia. With some A\$5 billion worth of sales, Boral has around 14,800 employees and a further 8,700 contractors and joint venture staff working across 706 operating sites and a further 146 distribution and administration sites globally. In Australia, Boral has around 10,000 employees and 6,000 contractors and JV staff working across 584 sites.

Boral produces and distributes a broad range of construction materials, including quarry products, cement, flyash, pre-mix concrete and asphalt; and building products, including clay bricks and pavers, clay and concrete roof tiles, concrete masonry products, plasterboard, windows and timber. Boral primarily serves customers in the building and construction industries with operations concentrated in three key geographical markets - Australia, the USA and Asia.

With leading reserve, manufacturing and market positions in all three geographic markets, Boral is also recognised as a leading company in sustainability practice and reporting. Boral is a member of the Climate Change Leadership Index for the Carbon Disclosure Project; the Corporate Responsibility Index Leaders Network; the Dow Jones Sustainability Index; and the FTSE4Good Index. Boral's key sustainability priorities include safety management, waste reduction and recycling, water conservation, climate change and emissions reduction, and sustainable product development.

Boral has operated solely as a construction materials and building products group since the Company's demerger in January 2000, when the former Boral Group, which also included an energy business, was demerged into two industry specific listed companies; Boral Limited and Origin Energy Limited. Since the demerger, Boral has invested close to \$2.5 billion in growth initiatives with around 60% of that capital invested in organica or Greenfield growth projects to expand market reach, improve product offerings and serve growing markets.

Boral's seven operating divisions encompass the following businesses:

### **Australian Construction Materials**

The Australian Construction Materials (ACM) division employs close to 4,600 employees and 1,300 contractors in quarry, concrete, asphalt, transport, contracting and land development activities throughout Australia. With around 400 operating sites, ACM's businesses include: Boral Asphalt, Boral Concrete, Boral Transport, Boral Quarries, Boral Waste Solutions and Boral Recycling. ACM has an important focus on concrete technology and the development of recycled concrete, asphalt and aggregate products.

### **Plasterboard**

The Plasterboard division is an integrated plasterboard manufacturing, distribution and installation business with 54 company-owned distribution and operating sites around Australia and employing around 650 people. Boral's Australian plasterboard business includes manufacturing of plasterboard, cornice and specialty plaster and jointing compounds as well as a 50%-owned gypsum mining operation and a 50%-owned joint venture in metal products for wall and ceiling lining systems. Boral also has a 50% share of Lafarge Boral Gypsum Asia (LBGA), the leading multi-country plasterboard producer in Asia (excluding Japan).

The plasterboard division continues to focus on the development of new plasterboard products and accessories focusing on lightweight building systems, sound proofing systems, fire-rated systems and recycled products. Boral owns Australia's newest and largest 'state-of-the-art' plasterboard plant in Queensland which is delivering significantly improved efficiency, quality and sustainability outcomes.

### **Cement**

The Cement division incorporates Blue Circle Southern Cement (BCSC) in Australia and PT Jaya Readymix (Indonesia) and Boral Thailand Concrete & Quarries in Asia. The division employs around 740 people in Australia across 13 operating sites and around 3,460 people in Asia across 95 sites.

BCSC is one of Australia's largest cement manufacturers and also a large producer of limestone for both internal and external customers. Through a 50% shareholding in Fly Ash Australia, BCSC is also a distributor and marketer of fly ash, a cementitious by-product used as a cement substitute. An important focus for BCSC is research and development into the increased use of fly ash as well as alternative fuels for cement production.

### **Construction Related Businesses**

Construction Related Businesses (CRB) is a portfolio of businesses comprising Boral Formwork & Scaffolding, De Martin & Gasparini (concrete placing), and Windows. It also includes the innovative precast concrete walling and flooring business trading under the names of Gir4otto and Go Crete. The division employs around 1,300 employees and 500 contractors across 31 operating sites across Australia. As a leading windows manufacturer, trading as both Dowell Windows and Brendale Aluminium Windows and Doors, Boral's windows business is currently focused on the development of more energy efficient window products and systems.

### **Timber**

The Timber division employs around 800 people in its hardwood, softwood and plywood operations, located on the east coast of Australia. Boral Timber operates 17 manufacturing sites and six distribution outlets. Products are sold into the structural, commercial and renovation markets and are distributed across domestic and export markets. In recent years, Boral built Australia's first engineered timber flooring plant on the NSW north coast at Murwillumbah, which is conserving Australia's native hardwood resources and supplying a market that was traditionally captured purely by imported products.

### **Clay & Concrete Products**

Clay & Concrete Products (C&C) manufactures and markets clay and concrete bricks, blocks, roof tiles and landscaping products. These products are widely used in a range of domestic and commercial walling, roofing and landscaping applications. Across 43 Australian locations, including 22 operating sites, C&C employs around 1,800 people and over 800 contractors. The products are sold primarily in Australia and New Zealand, however, speciality products are developed for markets in the USA and Asia. Other product development initiatives include lightweight blocks and increased use of recycled materials.