

5 February 2010



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Dear Sir

The New Research and Development Tax Incentive - Exposure Draft Legislation and Explanatory Materials

Please find below Transfield Services Limited's submission in respect of the Research and Development (R&D) Tax Incentive – Exposure Draft Legislation and Explanatory Materials released on 18 December 2009.

Company Profile

Transfield Services Limited ("Transfield Services") is publicly listed in Australia and included in the S&P/ASX 100. A leading global provider of operations, maintenance, and asset and project management services, Transfield Services has more than 28,000 employees in Australia, New Zealand, the United States, the United Arab Emirates, Qatar, New Caledonia, South East Asia, India, Chile and Canada.

Transfield Services delivers essential services to key industries in the Resources and Industrial, Infrastructure Services and Property and Facilities Management sectors. Demand for our services continues to be driven by the ongoing trend towards outsourcing non-core activities in both the private and public sectors. In challenging business environments, companies are under increasing pressure to deliver cost savings as well as improvements in productivity and reliability. By outsourcing non-core activities to Transfield Services, our clients are able to focus on core business, realising productivity, efficiency and financial benefits.

While Transfield Services has an extensive geographic presence, our focus remains on providing a tailored solution for each of our clients. Transfield Services is able to further expand its horizons as a leading provider of performance-based outsourcing solutions.

How the R&D Tax Concession Has Benefited Transfield Services

Transfield Services is an integrated service provider, delivering services across the full engineering value chain, including project feasibilities, project and capital works management, capital upgrades and rehabilitation, operations, maintenance and asset and facilities management services.

We have been accessing the R&D tax concession since 2001 and through consistent government support over the years, we have been able to increase our business investment in R&D to drive the development of new products and processes in our sector, as per the objectives of the current R&D tax concession.

We have now become a recognised market leader and innovator in the development of systems and solutions within the following industries and market segments:

Mining and Process

Hydrocarbons

Roads

Rail and Public Transport

Water

Facilities Management

Defence

Telecommunications

Power

How the New R&D Tax Credit Will Impact Transfield Services

We are concerned that the proposed R&D Tax Credit appears to be focusing on encouraging the development of advanced technologies within a small segment of the economy, while ignoring the key contribution of large companies in fostering economy-wide innovation and technology diffusion. Innovation is not restricted to new technology platforms.

Contrary to the Government's beliefs, large companies also rely on government support, to continue to invest in R&D activities within their industries in order to reduce costs and increase productivity, especially during trying economic times such as the present. It also allows them to remain competitive in the Global Economy which is becoming increasingly complex and challenging.

Transfield Services believes that the proposed changes to the R&D tax credit are overly restrictive and will certainly impact the ability of Transfield Services and other organisations to access this government incentive to continue to invest in R&D activities.

The three main areas of concern that Transfield Services has with regards to the new proposed changes are:

- Subsection 355-35 (2)(o)-(r) – Excluded Core and Supporting R&D Activities;
- Subsection 355-405 - Expenditure not at risk; and
- Subsection 355-450 - Feedstock Adjustments.

Subsection 355-35 (2)(o)-(r) – Excluded Core and Supporting R&D Activities

A key competitive advantage developed by Transfield Services lies within the information technology system underpinning its business operations.

Transfield Services' investment in ICT related R&D has resulted in significant efficiency and productivity improvements throughout our entire value and supply chain. This allows Transfield Services to offer improved service levels to its customers, relative to our domestic and international competitors, at a reduced cost, thus increasing our profitability and taxable income. It also facilitates the submission of tenders for new work, success from which contributes to the overall Australian economy.

Based on our understanding of the proposed multisale requirement, contained within subsection 355-35(2)(o), our legitimate R&D activities may be excluded from obtaining R&D assistance on the basis that Transfield Services does not currently charge its end user customers a direct fee for the licensing of its software developed by way of R&D. Our business model is such that a commercial return is indirectly received via improved profit margins arising as a result of increased efficiency and productivity. This improved profit margin still translates to increased taxable income. Efficiency gains are also good for our customers who enjoy increased levels of quality service.

Transfield Services also questions the rationale behind the inclusion of subsections 355-35(2)(p)–(r).

We believe that the R&D tax credit should be available to all forms of software development, provided they are undertaken for a commercial purpose and all relevant general eligibility requirements are met.

We also believe that proposed new definitions for a 'core R&D activity', and the requirement to meet the new proposed 'dominant purpose test' for supporting R&D activities should be sufficient to exclude the types of activities referred to in subsection 355-35(2)(o)–(r).

Subsection 355-405 - Expenditure not at risk

This section of the proposed legislation fails to recognise the commercial environment in which R&D activities are undertaken.

The unintended consequence of this section, as drafted, is a failure to support genuine R&D undertaken within a commercial context, where an activity is undertaken beyond that of a standard industry solution.

All eligible commercial R&D is designed to increase profitability and hence taxable income.

Transfield Services strongly believes this subsection needs to be removed.

Subsection 355-450 - Feedstock Adjustments

The form in which the "Augmented Feedstock Rule" has been proposed, has not been well-defined in the draft legislation and is a confusing extension of the current feedstock provisions. Upon studying the material, it is still very unclear as to what the scope of the expenditure caught by this "Augmented Feedstock Rule" is and how it applies to projects in our industry sector.

Applying the most conservative interpretation of this rule would mean that the Government is penalising all successful R&D and rewarding failed R&D. This cannot possibly be the intention of the Government with the introduction of this proposed legislation, if it sincerely hopes to increase the level of R&D activity across Australia.

Likely Consequences of the Proposed New R&D Tax Credit on Transfield Services

The draft legislation for the new R&D Tax Credit will impact Transfield Services' ability to claim support from the government in relation to developing new and improved products and processes to increase productivity within the sector we operate. The same would apply to other sector participants. This may result in an unintended consequence of reducing company profitability and growth in the sector. This must be the opposite of the Government's intention from this legislation.

In the aftermath of the global financial crisis, where cash flow is tight, the lack of support from the government may drive business decisions that are detrimental to Australia's competitiveness in the World economy and may result in stagnant growth over the longer term.

As such, Transfield Services strongly urges the government to remove the exclusive restrictions in the draft legislation as this will have the opposite effect to that intended by the government. The narrow application of the credit, in the form proposed, is more likely to lead industry players to decrease their spend on innovation, not increase it.

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Should you have any queries in relation to this, please do not hesitate to contact myself (02) 9464 1604 or Craig Bennison (02) 9464 1621.

Thank you.

Yours faithfully



Tiernan O'Rourke
Chief Financial Officer
Transfield Services Limited