

24 July 2018

Manager  
Small Business Entities & Industry Concessions Unit  
The Treasury  
Langton Crescent  
PARKES ACT 2600

By email to: [RnDamendments@treasury.gov.au](mailto:RnDamendments@treasury.gov.au)

Dear Sir/Madam,

Thank you for the opportunity to respond to the proposed amendments to the R&D Tax Incentive program 2018.

The Drouin West Timber and Truss (DWTT) business commenced operations at Drouin VIC in 1980 and is a privately owned company. The business has continually been driving innovation and is at the leading edge of the residential and light commercial building industry.

DWTT's core business is a manufacturing facility in Drouin VIC that has continually evolved in line with best practice principles including installation of world leading automated timber machinery equipment and truss assembly lines. These systems have enabled the business to produce the highest quality timber based prefabricated systems used for roof, wall and floor trusses in residential and light commercial construction.

In 2014 DWTT pioneered 'off site manufacturing' in Australia with the introduction of the DWTT FutureFit™ Panelised Building System. FutureFit™ incorporates the traditional 'on-site' construction elements into more advanced construction components being 'floor cassettes' and externally clad, window fitted 'wall panel' systems that are manufactured 'off site'. Development of these advanced components required the establishment of a state of the art dedicated factory and installation of world class, automated CAD and CNC driven plant and equipment from Europe and the USA.

FutureFit™ panelised building system is a evolution in building construction methods, namely the delivery of completed floor cassettes and wall panels directly to the building site where crane transfer and installation / erection is achievable in hours, compared to days or weeks with the current manual onsite traditional methods. The FutureFit™ construction method enables significantly faster construction, lower construction costs, reduced workplace safety risks, higher productivity and more efficient conversion of raw materials to finished product through automated and optimised timber processing and assembly.

FutureFit™ is the culmination of significant investment and diligent market research into the emerging trends in residential and light commercial construction methods. The market research confirmed that builders and developers need faster and on-time construction methods, reduced costs of construction, safer site construction methods and improved resource utilization.

The current achievements of DWTT FutureFit™ are:

- Being an early innovator by introducing the latest evolution in building construction methods.
- Introducing world class, productive manufacturing innovation to the building and construction industry.
- Positioning DWTT FutureFit™ as an innovative manufacturing enterprise in Australia.
- Enabled the building industry to access world class building and construction innovation techniques that are both time and cost effective building solution.
- Enabled the business to generate significant new sales revenue, clients and generate a sustainable operating EBIT profit.
- Created a sustainable, resilient, value adding enterprise that bridge across two key propulsive sectors. These two sectors are manufacturing and construction.

A large proportion of the above achievements have been achieved through significant R&D funding and subsequent expenditure as a ongoing investment in our business and industry where all end users benefit.

DWTT FutureFit™ presents a paradigm opportunity to the building industry and will continue to innovate and adapt our offering into new market segments such as Medium Density Housing and Aged Care. Having recently secured 'preferred supplier status' with two of Australia's leading construction companies (Mirvac and Lend Lease) supports DWTT's belief in maintaining a leading position in the evolution in offsite building construction in Australia.

We do understand the need for controlling the impact that this program has on the Federal Budget and our responses should be viewed in this light.

### ***Calculation of R&D Intensity under the R&D premium $\geq$ \$20 million Turnover***

This change appears to be based on a belief that this will increase the incentive for larger companies to invest a higher percentage of their total expenditure on R&D.

It is our contention that:

- Such a belief may be true for smaller entrepreneurial enterprises where the program often underwrites the additional employment of an R&D specialist
- The focus and investment of R&D in larger companies is determined almost totally by the needs of the company – in marketing terms - and that having a rising scale of reward, as proposed, will not change this focus or investment. For example, many companies would fall into the category that would receive



a net benefit in the range of 4% to 6.5% and may determine that this does not warrant the effort and cost of making a claim.

Thus, we question the entire basis for the changes in this regard.

As to the calculation of R&D intensity, we foreshadow significant problems and unforeseen effects:

- Companies with high trading volumes and low margins, particularly in manufacturing, will be penalized by the changes as their total expenditure is a very high percentage of their revenue. Companies with low input costs and high profit margins, such as the gambling industry, could be advantaged.
- Drouin West Timber and Truss P/L are a company of this size and fall into the manufacturing sector and, in some cases, the existing program is a borderline proposition in terms of net benefit – the benefit after the costs of inclusion.
- While there is a correlation between the intensity of R&D activity and turnover growth<sup>1</sup>, there appears to be no evidence that increasing the relative benefit of the program to high intensity enterprises will have a positive effect of encouraging addition R&D activity. The premise of the program is that by offering higher benefits for greater intensity of R&D expenditure this will provide an incentive for companies with lower intensity to increase their R&D spend, in order to gain a higher benefit. There is no evidence to support this contention.

### ***Companies with ≤ \$20 million Turnover***

We have been struck by the lack of comment in the media relating to the proposed reduction of the net benefit of the program for small business from 15% to 13.5% - **a reduction of 10% in net benefit**. While innovation in this sector is significantly supported by the program, the proposed change appears at variance with the Government's focus on increasing innovation and supporting jobs growth in smaller, often family based, manufacturing businesses like Drouin West Timber and Truss P/L. This is a sector that has been decimated over the past 20-30 years and what little government support is left is gradually being whittled away.

### ***Other Issues***

#### ***\$20 million Threshold***

We have some doubts about use of a \$20 million aggregated turnover threshold as this penalizes businesses with high input costs such as manufacturing.

The manufacturing sector is penalized by the reduction in benefit of the program once \$20 million in turnover has been reached. Service industry and companies that operate in conditions of oligopoly, where higher margins are prevalent, can generate

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<sup>1</sup>

Australian Innovation System Report 2017, Department of Industry, Innovation and Science, p 69

similar returns with less than half the revenue and, yet, are given a much higher net benefit by the program.

Perhaps aggregated turnover is not the best measure for determining benefit in the program.

### Australian Government's Investment in Innovation

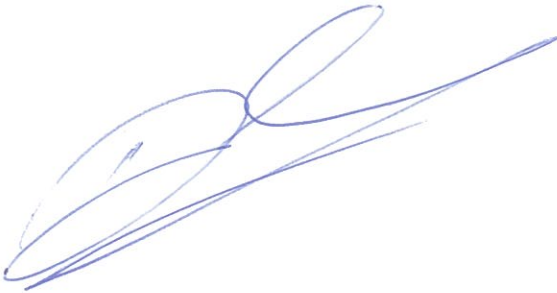
The Chief Economist's Australian Innovation System Report 2017 clearly identifies a strong correlation between the level of R&D Activity and growth in turnover, labour productivity and wages<sup>2</sup>. And, yet, the Government is reducing its investment in the support of R&D and innovation.

### ICT Sector

We note that the rapid expansion of the proportion of the benefits of the program has come from the ICT sector.

The dramatic change in interpretation of the Act relating to the ICT industry is understandable in light of the scale of this sector, in terms of the percentage of the total cost of the program that this consumes, and the rate of growth of the value of applications. However, it is our perception that the issue would have been better addressed by excluding ICT from the R&D Tax Incentive program and mounting a separate incentive program for this industry. This would have allowed much better targeting of benefit. Grant programs could also have been used to refine the desired result and the Government could easily gauge the impact of such a program on persuading companies to retain ICT development in Australia as opposed to moving this activity to cheaper suppliers in Asia.

Yours faithfully



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<sup>2</sup>

Australian Innovation System Report 2017, Department of Industry, Innovation and Science, pp 69-79