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Dear Sir / Madam

CONSULTATION PAPER: THE NEW RESEARCH AND DEVELOPMENT TAX INCENTIVE

This letter is in response to the consultation paper jointly released by the Treasurer and Minister for Innovation, Industry, Science and Research on 18 September 2009, regarding the proposed replacement of the existing research and development (R&D) tax concession by a new R&D tax incentive from 1 July 2010.

BlueScope Steel generally supports the position explained in the submission made by Michael Johnson & Associates on 26 October 2009 regarding the new R&D tax incentive.

In addition, this letter provides background about BlueScope Steel and its R&D activities, and some comments regarding elements of the Government's proposals that are of particular relevance to the company.

About BlueScope Steel

BlueScope Steel is an Australian listed company (ASX: BSL) and the leading producer and supplier of flat steel products in the Australian market. BlueScope Steel produces steel products, including slab, hot rolled coil, cold rolled coil, plate and value-added metallic coated and painted steel products for use in the building and construction (commercial, residential and engineering/infrastructure), automotive and manufacturing industries.

BlueScope Steel's Australian iron and steelmaking facility is located at Port Kembla (NSW), while a rolling, coating and painting plant operates at Western Port (Vic), along with metal coating and painting plants at Springhill (NSW) and painting plants at Erskine Park (NSW) and Acacia Ridge (Qld). The company operates 38 BlueScope Lysaght building products manufacturing plants. It also distributes both long and flat steel products through 82 distribution outlets and 4 sheet metal supplies outlets, and has 16 BlueScope Water sites in Australia. The Port Kembla Steelworks is an internationally competitive integrated steel plant, with an annual production capacity of approximately 5.3 million tonnes.

Normally, approximately half of BlueScope Steel's annual Australian production is sold domestically and the balance in the export market. The company's Australian exports were valued at some \$2.3 billion (approximately 2.5 million tonnes) in the 2007/08 financial year. While rankings vary year-by-year, steel products are generally amongst Australia's top twenty goods exports by value. Key export destinations for BlueScope include the United States, South Korea, Thailand and Indonesia, and to a lesser extent Europe, Africa and the Caribbean.

BlueScope Steel has established a substantial international footprint including an integrated steelworks in New Zealand, a flat products steel-mill joint venture in the United States (Delta, Ohio), and metal coating and painting facilities in China, Vietnam, Indonesia, Thailand and Malaysia. Building products manufacturing plants are located throughout the Asia-Pacific region, and the company is a leading manufacturer of steel pre-engineered buildings in the USA and China. In 2008, BlueScope Steel acquired the IMSA steel businesses in North America.

BlueScope has an Australian based direct workforce of about 9,000 employees, with a further 9,000 worldwide.

Research & development by BlueScope Steel

Innovation is key to the continued growth of BlueScope Steel's premium, differentiated product portfolio. Innovation underpins our competitive edge as a leading supplier of quality branded building and construction products to markets in Australia, New Zealand, South East Asia and the USA.

The company's R&D activities fall into two main categories: improved or new product properties; and new applications for our products. Improved product properties increase the product performance experienced by the customer. For example, improving the durability of paint systems so that COLORBOND® steel stays brighter for longer and colours do not fade, and searching for ways to increase the corrosion resistance of the protective ZINCALUME® steel metal coating. This improves product performance and allows product warranties to be extended, providing benefits for our customers. The overarching goal is to find improvements that simultaneously improve 'performance', reduce costs, and promote sustainability, typically by using less raw materials and energy in manufacturing.

In terms of new applications, we look for new ways of using steel to promote efficiency, cost reduction, and utility in design. Two current examples are a steel reinforced concrete slab wall that greatly decreases construction time; and a building integrated solar cell that is laminated directly onto COLORBOND® steel roofing. Both of these are presently under development and not yet commercialised. It is anticipated that significant further research and development will be required as part of the prototyping and scale-up of these technologies. The scale-up phase is where the greatest financial risk to the developer occurs because it will typically require substantial capital investment in plant and equipment that may be completely unique to the development.

BlueScope Steel's innovation activities have resulted in world leading market share achievements for steel in building and construction applications. For example, nearly 50% of all new residential buildings in Australia have a steel roof; this compares to ~1% in the USA. We also enjoy very high rates of adoption of steel in house frames. In Asia, we have developed a 'clean' COLORBOND® steel that addresses the widespread problem of tropical discolouration (building exteriors become 'dirty' over time). This product is a market leader. BlueScope is responsible for worldwide licensing of GALVALUME® steel technology, which has now been adopted by some forty other steel producers. Over the last 40 years our company has developed a reputation in the steel industry for continuous innovation of steel coatings, underpinned by a commitment to investment in fundamental R&D.

BlueScope has also led the world in the development and adoption of new and improved coating manufacturing technology, with the primary aim of reducing production costs and energy consumption. Normally the application of the metal coating layer for corrosion protection, and the paint layer for decoration and colour, are done on two separate processing lines. We have recently implemented a new paint curing technology – near infrared (NIR) – to replace conventional convection ovens. This allows for reduced energy consumption, a simpler process route, and avoidance of significant capital cost because the paint coats can be applied directly after metal coating, on the same process line. Although this innovation has subsequently proven to be viable, significant capital cost and risk was involved in the development of the process from pilot to industrial scale.

We have approximately 300 technical staff whose principal role is to carry out research and development activities. Approximately 150 technical personnel are located in our corporate R&D laboratories in Port Kembla, which are equipped with state-of-the-art technology for analysis, measurement, simulation and characterisation of our products. We are fortunate to have more than 40 PhD qualified staff members, which enables us to conduct fundamental research within the corporate R&D environment, as well as supervising research work carried out in collaboration with universities and research institutions. Each year we spend over \$3 million on collaborative R&D projects with Australian universities. This includes sponsorship of undergraduate students through scholarships, Australian Research Council (ARC) projects, and direct support for the BlueScope Steel Metallurgy

Centre at University of Wollongong. We also indirectly support a number of universities in NSW through employment of cadets that we require to undertake undergraduate degree courses.

Comments on the proposed R&D tax incentive

Our concerns with some of the proposals announced in The New Research and Development Tax Consultation Paper released in September 2009 are explained in the following points.

1. Creating separate rules for Systematic, Investigative and Experimental Activities (Core Activities) and Directly Related Activities (Supporting Activities) will cause considerable uncertainty, leading to increased complexity and compliance costs. The process of identifying whether an activity is core or support will become very subjective, and give rise to increased disputes as to where the boundary lies.
2. There is an inference that R&D work undertaken in a production environment is less likely to be truly innovative and risky when compared to R&D carried out in a laboratory. Industrial R&D is typically aimed at the commercialisation of new or improved products or manufacturing processes. In our experience, the successful commercial development of new products, and the implementation of new process technology can only occur in a production environment. These developments and/or innovations cannot occur in isolation from our production facilities. To suggest that these activities are less important would ignore the spillover benefits that extend beyond our company to the other companies that we deal with directly, our customers or to the wider community at large.
3. The current tax provisions require that supporting activities have a direct relationship to the Systematic, Investigative and Experimental Activity (Core Activity) to be eligible. An Industrial R&D project would not be able to proceed to completion without having carried out the directly related activities (supporting activities) to meet the project's technical objective. To deny the directly related activities (supporting activities) the same incentive rate is to diminish the value of these activities.
4. An Industrial R&D project requires completion of all related activities to achieve the technical objective and to ultimately have the required spillovers to the community, therefore all activities should be incentivised equally.
5. The proposals espoused in paragraphs 56 to 70 of the Consultation Paper to provide limits around supporting activities would considerably reduce the benefit of the R&D Tax Incentive to our company.
6. The proposed restrictions around Supporting activities will not provide any certainty to the existing rules, rather they will add considerable uncertainty, increase the complexity in the determination of eligible expenditure and increase compliance costs.

Conclusion

BlueScope Steel supports the initiative to implement a simplified tax credit, and understands that the changes are designed to be revenue neutral in order to maintain the current level of support for R&D. However, we believe that by placing restrictions on supporting activities the measures will be far from revenue neutral and will greatly reduce the overall level of support for R&D. The R&D tax credit should support not only the 'research' aspect of R&D but also the application or 'development' side if it is to deliver the desired spillover benefits to the community.

Thank you for the opportunity to make a submission. For further information regarding our submission please do not hesitate to contact me on (02) 4252 3175 or David.Varcoe@bluescopesteel.com

Yours sincerely



David Varcoe
GENERAL MANAGER PRODUCT R&D