RIDLEY

General Manager
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The Treasury
Langton Crescent
PARKES ACT 2600

**2 February 2010**

To Whom It May Concern

On behalf of **Ridley Corporation Limited** I welcome this opportunity to provide feedback on the exposure draft of the Tax Laws Amendment (Research and Development) Bill 2010 released 18 December 2009 ("the exposure draft").

Ridley Corporation Limited ("Ridley") manufacture and markets salt, stockfeed and animal feed supplements. Its two businesses are Ridley Agriproducts, the country's leading supplier of stockfeed, and Cheetham Salt, Australia's largest producer and refiner of salt. Ridley currently employs over 800 Australian's within its combined businesses, which are located throughout Australia.

Ridley's reputation and market success are built on an extensive program of research and development. One of the cornerstones of Ridley's eminent position in markets across the world is commitment to product quality; and driving that product quality is a vigorous and rigorous program of Research and Development.

All stockfeed, supplement and premix products manufactured and supplied by Ridley AgriProducts are the result of extensive research and development. Ridley undertakes R&D programs across the broad range of livestock and aquaculture

## Research Highlights

### Cheetham Salt

Cheetham Salt is currently involved in a diversity of research and development activities throughout its business, and in the area of salt field biology is working with leading global experts to develop novel control techniques to reduce the impact of blue green algae in tropical solar salt fields.

### Ridley AgriProducts

Feed Manufacture – Various initiatives have been undertaken in the area of feed manufacture and the associated impact on animal performance. Ridley continues to contribute to the MLA's Premium Grains for Livestock Program (PGLP), with evaluations of grain type (Wheat, Barley, Triticale, Sorghum) and potential economic benefit to stakeholders.

Pig – Ridley AgriProducts, as a contributor to the Pork CRC, is synergising efforts in applying novel ingredients, feed processing and their impact on critical ingredient digestibility. Further work is associated with evaluating new nutriceutical ingredients and their impact on total lifetime performance.

Poultry – Research during the past few years has largely focused on laying hen nutrition and the availability of plant bound minerals. Current activities include dietary influence on yolk colour and quality parameters, performance of meat chickens when fed vegetable based ingredients, pullet starter programs and the impact of feed processing on the performance (growth, feed efficiency, health) of different classes of poultry.

Dairy – Recent research has revolved around various raw material evaluations, including rumen buffers. Future research initiatives include supplementary feeding strategies and nutrient modelling for pasture based feeding systems. Calf rearing trials, during the first 6 weeks of life, will focus on growth, feed efficiency and health.

Beef - Current beef cattle initiatives are examining the economic production benefits from rumen manipulations when feed particular supplementations, novel ingredients and health enhancing additives.

Sheep – A new range of loose mix supplements has been the recent outcome of extensive on-farm and feedlot studies. Further development and expansion of applications across the lamb meat and breeder sectors of the industry are underway.

Aquaculture – Prawn diet development has brought forward an efficient highly digestible product offer that the industry has applauded. New fin-fish seasonal diets, manipulating nutrient composition and density have produced cost effective programs that optimise overall grow-out performance.

Based on the R&D tax concessionclaim for the year ended 30 June 2009, Ridley has spent over $4m in eligible R&D expenditure, which resulted in a tax benefit of $1m to the business.

Based on the proposed changes that have been released in the Exposure Draft, the ability of the company to continue its current expenditure on R&D will be significantly reduced. A number of projects that are currently being claimed may be cancelled should the business not be able to fund the current R&D spend out of cuts to other budgets. Based on the current reading, it is doubtful that these projects will process considerable novelty and technical risk. In additional, approval for large R&D projects will be harder to be achieve as the cost to the business will now, generally, be increased by 25%. There are also a number of employees whose main role is split between supporting R&D projects and other manufacturing roles within the business . The decrease in eligibility of these now "supporting" R&D activities spend could result in a change in the employment numbers in our various divisions. In addition, Ridley's R&D team may lose technical know how as previous employee's working part time on R&D projects are unable to spend time on a project as there time will no longer a business benefit (through the tax concession) of allocating an employee to support the R&D team. Sending the R&D research offshore may also prove to be more cost effective, should the additional tax benefit be lost.

Our company commends the Government's stated intent in delivering a "more generous, more predictable, and less complex tax incentive", however we do not believe the legislation achieves this intent in its present form.

Whilst we understand the Government's intention to tighten eligibility in order to focus incentives on worthy activities which will benefit the broader Australian economy, we believe the combination of *the high number* of tightening measures contained in the exposure draft serves to drastically reduce the generosity, accessibility and attractiveness of the R&D Tax Incentive program.

**Major concerns**

Within the exposure draft, there are now five key ways in which eligibility has been significantly tightened and claims will be curtailed, making the system *less generous, more complex and less predictable* to Australian businesses.

1. The requirement for 'considerable novelty' in place of 'innovation' – this both raises the bar for eligibility of potential claimants, while increasing uncertainty by replacing a well understood and defined term. Innovation is a well understood term, and the relationship between innovation, productivity and growth is similarly well understood, across OECD countries and in a local context. The shift in term seems to favour the "blue sky" R&D common in academic settings over business innovation – the incremental improvements which are vital to business competitiveness;

2. The introduction of the "and" test for the eligibility test of considerable novelty and high levels of technical risk. We believe that this change to the definition will lead to the exclusion of many genuine R&D activities that should be supported and are currently eligible for support under the existing R&D tax concession. As a stand alone measure, this change may be acceptable, but in combination with the other new eligibility restrictions, it will exclude too many meritorious R&D endeavours and overall support for innovation will be considerably reduced. If this change is to be adopted, then other proposed restrictions should not be introduced otherwise the aim of the new tax credit to provide a more generous concession will not be fulfilled.

3. The introduction of the "dominant purpose" test for supporting activities. This represents a significant tightening over the existing test in the current program, which only requires that a support activity be carried out for "a" purpose directly related to the core R&D activities. This new test will greatly reduce the amount of eligible support activities that may be claimed, and will also impose a severe evidentiary burden on claimants of the new R&D tax credit. Many support activities will have a commercial purpose as well as an R&D purpose and providing evidence that one purpose is clearly dominant over the other will be almost impossible in many cases. This introduces considerable uncertainty over the eligibility of claimed supporting activities and is highly undesirable as a consequence. Please note, this uncertainty is acknowledged in the discussion of the new test in the Explanatory Memorandum.

4. The apparently arbitrary exclusion of a large number of activities from being either core or supporting activities, via the repurposing of the former s73B(2C) of the Income Tax Assessment Act 1936 (ITAA 1936). We believe that this change, while having obvious negative consequences for the computer science and information technology industries in Australia, also has (possibly unintended) consequences, including that:

    a. the expansive drafting of s355-35(2)(h) suggests that manufacturing industries will have eligible R&D processes, including trials, drastically reduced;

    b. s355-35(2)(i) is broadly drafted and confusing.

    c. s355-35(2)(o,p,q and r) which will result in the exclusion of the majority of IT related R&D from obtaining support under the program.

5. The "augmented feedstock provisions", effectively limit R&D Incentives to the net expenditure on the R&D activities. This obviously decreases the generosity of the incentive, however it has other major consequences:

    a. it makes the incentive less predictable, as the value of the output may be clawed back at a future date, making budgeting projects and accounting for incentives difficult (i.e. how would one carry the potential liability?);

    b. it favours failure over success. We believe that having taken on the technical and financial risk of an R&D activity, a claimant should not be negatively treated at a indeterminate point in the future due to the disposal of the outputs of R&D;

    c. the scope of what is included in the "output's cost" should not include labour and plant depreciation. A company takes on a real *opportunity cost* by diverting staff and assets from normal duties to an R&D activity – this cost is in fact never fully recovered, even if the outputs of R&D are sold. The current feedstock provisions of the R&D Tax Concession, which deal only with material inputs and energy, amply claw back incentives on profitable trial activities.

**Submission Request**

There is, presently, a unique opportunity to draft the legislation precisely and specifically to meet the policy intent – this opportunity should not be missed. Given the above issues and complexities in the current exposure draft, we submit that the Government should:

1. **Leave in place the well understood term – Innovation in the definition and remove the term considerable novelty;**
2. **Delete the exclusions list and thereby not use it as a means to limit supporting activities, or, if absolutely necessary to achieve policy objectives, redraft s355-35(2) to <u>clarify</u> those activities which are intended to be excluded;**
3. **Remove the specific exclusions on computer software to ensure that genuine R&D undertaken that is information technology related is supported by the R&D tax credit program going forward; and**
4. **Revert to the existing feedstock provisions of s73B of the ITAA 1936 which, we believe, effectively limit incentives to net cost of trials or alternatively quarantine some specific activities from being treated as input costs in the augmented feedstock provisions. We request that two categories of costs be quarantined (and not included in the feedstock calculation) being labour and plant depreciation.**

If the above changes are made to the exposure draft, the Government will be able to achieve its objectives for the new tax credit – that is, implement a more generous, more predictable and less complex incentive that targets additionality and spillovers whilst maintaining revenue neutrality.

However, if the Exposure Draft is implemented in its current form, the direct outcome would be a significant lowering of the support for innovation in Australian businesses. As a result, the Government risks losing scientific, information and engineering and other technical industries (and jobs) offshore, as well as reducing the development of products, technologies and processes which will boost productivity – the very lever which the Government has stated will support an aging population. Reduced effectiveness and uptake of the R&D Tax Incentive will also negatively affect Australia's Business Expenditure on R&D ("BERD").

If you would like to discuss this submission, please feel free to contact me on **03 8624 6535.** Please note that my office hours are Monday and Tuesday 9am to 5.30pm.

Yours sincerely

**Melissa Fisher**
**Tax Manager**
**Ridley Corporation Ltd**