

CSR LIMITED

Locked Bag 6 Chatswood
NSW 2057 Australia
T 61 2 9235 8000
F 61 2 9235 8044
www.csr.com.au
ABN 90 000 001 276
5 February 2010

Martin W Jones
General Manager
Government Relations
0419 475 962
mwjones@csr.com.au

General Manager
Business Tax Division
The Treasury
Langton Crescent
PARKES ACT 2600

Email: rdtaxcredit@treasury.gov.au

Dear Sir/Madam,

Tax Laws Amendment (research and Development) Bill 2010 - Exposure Draft

Thank you for the opportunity to comment on the exposure draft legislation.

CSR Limited has been operating in Australia for 154 years. The company is a leading diversified manufacturing company with operations throughout Australia, New Zealand, China and South East Asia and employs over 7000 people. In 2009 trading revenues were \$3550m with capital expenditure of \$377m. The company essentially operates three manufacturing divisions, comprising Building Products, Aluminium smelting, through our shareholding in the Tomago aluminium smelter, and Sugar.

Our Building Products' Division is a leading supplier to the residential and commercial construction industry - supported by a nationwide distribution network. It manufactures well known brands such as Bradford™ Gold glass wool insulation, Viridian™ flat glass and downstream products, Gyprock™ plasterboard, Cemintel™ cement sheeting, Monier™ and Wunderlich™ roof tiles, PGH™ bricks through 35 wholly-owned or majority owned manufacturing plants in Australia and operations in New Zealand and Asia.

CSR Sugar is the 6th largest sugar company in the world and the largest raw sugar producer in Australia, operating 7 mills in northern Queensland. Australia exports 85% of the raw sugar production and CSR through its joint venture with Mackay Sugar Limited exports about 30% of our refined sugar production. CSR Ethanol is centred on production in Sarina, Queensland and mainly produces fuel grade bio-ethanol for the Australian market.

The Tomago Aluminium smelter, of which CSR has an effective interest of 25%, is the second largest employer in the Hunter Valley with 1200 direct employees and generates \$1.5b pa in sales of which 85% are exported. It is the 10th largest smelter in the world.

While we don't publicly report our qualifying R & D spend, it has historically been substantial. Research is broad across our sugar business, involving sugar cane varietal developments, improved processes and new products. Innovation is necessary to stay competitive internationally as well as in our own markets. There is an ongoing effort to develop more sustainable products. The nature of this legislation appears well intended, although if implemented as suggested will be a significant set back for R & D at CSR. We have broadly estimated that 70% of the intended benefits would be lost. Furthermore the complexity and additional uncertainty introduced by the proposed changes makes funding R & D a much riskier and less attractive proposition than under the existing rules.

While CSR welcomes some of the proposed changes, namely the elimination of open ended amendment by the ATO for R&D matters and the advanced findings process of eligibility, this is more than offset by the negative impact the proposed Bills would have on our business.

Specifically:

Stated intent of the new law

- Cutting red tape and providing tax incentives for R&D is laudable.
- The intent of the changes to redistribute the program benefits in favour of SMEs is for large companies like CSR, counterproductive. Large enterprises employ a significant amount of Australians and rely on innovation to develop new products and processes. An intent to penalise them simply by virtue of size is counter-intuitive and not in Australia's best interests. Large companies are excluded from many forms of Government assistance in the area of innovation. It is unfair to further exclude large companies from the R & D space – while large companies may have more funding to direct to R & D, they will be incurring proportionately larger risks and this should be taken into consideration.

Eligible activities

- The tightening of the definition of a core R&D activity to require considerable novelty (previously just "innovation") and have high levels of technical risk is disadvantageous to companies that actually produce things. Value added manufacturing is a major source of economic activity in Australia. Many of these R & D projects involve production efficiency, product innovation and productivity-style innovation. Australia has one of the most open markets in the world for manufactured items and innovation is essential to maintain competitiveness.
- The requirement for "the probability of obtaining a given technical or scientific outcome (not being) known in advance" is prohibitively restrictive. This type of research activity is not a binary fail-succeed situation, and to some extent the intended outcome may be likely to be achieved. This very strict criterion is likely to eliminate some very innovative and value-generating R&D activity.
- The exclusion of pre-production activities "incl. demonstrating commercial viability, tooling-up and trial runs" will have significant consequences for innovative companies including manufacturing and technology companies. The trialling of products prior to commercial production is an important part of the innovation process and still a source of great risk and product failure. CSR is involved in significant trialling which does not necessarily result in a technology or product going forward

For example:

- Sugarcane breeding is an important activity. CSR has significant expenditure on sugarcane breeding annually trialling many thousands of sugarcane clones. A new product is only released every few years; this suggests a failure rate of 99.9% for any individual sugarcane clone under trial.
 - Extensive trialling of product processes is necessary in a manufacturing environment to demonstrate not just efficiency but safety. There is very little guarantee that an innovative new process or design will be both efficacious and safe.
- About 85% of CSR R & D expenditure involves trialling high-risk products or where both safety and efficacy must be assured or is far from given.
 - Other industries must suffer greatly from this imposition as well
 - In agriculture, all breeders of crops and animals require trials.
 - Pharmaceutical and healthcare industries have trials as an extremely high-risk part of development; fewer than 10% of products which enter clinical trials are ever commercialised.
 - Manufacturing generally will trial many prototypes of new designs or new products that are never released.

Exclusion of commercial, legal & administration

- The exclusion of commercial, legal and administrative aspects of patenting, licensing or other activities has a significant effect on industries which perform R&D
- Ensuring the protection of valuable IP by patent, and capturing the value for Australian enterprises through patenting and associated licensing, is a crucial step in innovation and R&D. By providing a disincentive for protecting IP through the patent process the Law is inconsistent with the stated intent of providing benefit for Australia, since foreign competitors can take advantage of Australian innovation without penalty if patenting is discouraged.
- Additionally and by definition, if a product or process is patentable it is new, innovative and useful so the exclusion of IP costs is nonsensical and inconsistent with the government's stated purpose of fostering innovation.
- **The exclusion of patenting has the effect of reducing CSR Sugar's eligible expenditure by about 10%.**

Feedstock rule

The augmented feedstock rule, as proposed, changes the very nature of consideration of R&D as an activity in Australia, effectively removing the Federal Government from meaningfully fostering research and innovation to being a compensatory body if the research happens to fail.

To the extent that parties do perform R&D, if it is successful, the augmented feedstock rule will likely wipe out any value of the tax offset. Companies, however do plan (or at the very least hope) to be successful and produce valuable output from research, either as new products or process improvements, so they will not necessarily expect to receive the benefit (since they "plan for success").

- This will likely change the business case for research projects and render many projects non-viable, and in fact result in less research being done, which is counter to the stated aims of the policy.
- Managing the chance that a project fails, companies will have to undertake considerable administrative burden to maintain suitable records. In the event the program was a success, this money was wasted – further eroding the business case of a successful project, and spending money on unnecessary compliance preparation that could have been saved or spent on research.
- **If implemented in the recent FY in its strictest interpretation this would have meant approximately 70% of CSR's research would likely be ineligible and unlikely to have been undertaken in full.**

Summary

The proposed new law amounts to a radical change in the way the Federal Government supports R&D in Australia, indeed it will act to ensure that the Federal Government drastically decreases its support for R&D in Australia since much existing R&D will become ineligible, with the added effect that companies will therefore engage in less of it.

The proposed new law is a significant step back in the fostering of innovation in Australian firms, and primarily due to the *augmented feedstock rule* this effect is exacerbated in companies such as CSR which manufacture and sell products but at the same time seek to innovate in their marketplace. While the tax offset provisions will provide a similar benefit over the deductibility method, it is hard to understand how the Government can claim neutrality, when the eligibility criteria have been restricted so greatly. Release of the Government's considerations might add clarity to these claims.

To conclude it appears that the Government is shifting from what is effectively and innovation, research and development policy to a regime of research only. The public interest is well served by viable companies investing broadly in R & D, maintaining the competitiveness of Australian industry internationally.

Yours sincerely,



Martin Jones