



Contact

Phone: +61 7 3810 0512

Fax: +61 7 3810 0555

Email: mbusch@newhopecoal.com.au

Our Ref:

Your Ref:

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

CONSULTATION PAPER: THE NEW RESEARCH AND DEVELOPMENT TAX CREDIT

New Hope Corporation Limited (New Hope) is pleased to have the opportunity to provide comment on the Consultation Paper entitled the New Research and Development Tax Incentive ('the Consultation Paper').

New Hope's Business

We are an independent energy company, which specialises in thin-seam mining. The company has open cut mines at Acland on the Darling Downs, and at Rosewood near Ipswich. New Hope focuses on niche marketing of its thermal coal and exports around 65 per cent of its coal production to Asia Pacific markets including Japan, Taiwan, China, Korea and Chile with the remainder being consumed by customers in south-east Queensland. The company also holds various exploration tenements in central Queensland and on the Darling Downs in southern Queensland. With our head office at Brookwater, New Hope manages each step in the coal chain, from exploration and mining the mineral, through to delivering it to customers. The company and its subsidiaries interests include coal mining, port operations, other resource based activities in Queensland, agribusiness, and emerging coal to liquids and coal seam gas technologies.



New Hope and R&D

New Hope has a long history of investing in R&D and has previously received assistance from the Government in the form of the R&D Tax Concession to support this investment. The company believes that innovation and R&D are core components to its business operations and helps to stand it apart from its competitors. For instance, through a comprehensive program of eligible R&D, the Group has successfully developed a complex thin seam coal mine at Acland, near Toowoomba, Queensland, which employs 256 people and contributes to the local community. Without the company's investment in R&D, this precious resource would very likely never have been recovered as most coal mining clients would consider the tenement too difficult to mine.

New Hope also has plans to diversify into new technology fields and is pursuing a Coal to Liquids initiative. The project is targeting excellent environmental credentials and plans to be a great example of clean coal technology. The design targets CO₂ equivalent emissions of less than 10% of that generated by the equivalent amount of coal burnt in a conventional power station, or less than 20% of the CO₂ generated by the equivalent energy of natural gas consumed in a power station. In oil equivalent terms this equates to less than 100kg of CO₂ per barrel of oil (159 litres). This outcome, if achieved, is significantly improved upon a commonly held perception that Coal to Liquid processes can create up to one tonne of CO₂ per barrel of oil equivalent. The benefit of the R&D tax concession has been a key consideration of the company's ability to fund this revolutionary initiative, and similarly the new R&D tax incentive will be a key consideration going forward. New Hope accounts for R&D incentives in its R&D planning process and reductions in R&D incentives may jeopardize projects like this, or in the least, restrict the speed at which they can proceed.

New Hope's contribution to the discussion on the new R&D tax incentive

Our comments and suggestions in respect of the consultation paper on the new R&D tax incentive are included below.

Principle 1

The new R&D tax incentive will be available to companies incorporated in Australia for R&D conducted in Australia. Location of ownership of the resulting IP will not be relevant.

New Hope supports this principle.

Question 1 - Should there be any exceptions to the general rule that eligible R&D activity must be conducted in Australia?

Australian businesses that are looking to conduct world leading R&D, export their products and need to be internationally competitive are discriminated against under the current provisions. The 10 percent allowable overseas percentage provides limited incentive. This is particularly true where the testing or trialling facilities are not available in Australia, and is often the case where 'blue sky' or cutting edge technology is being developed.

For example, our plans to develop a coal to liquids process will require expertise and facilities only available overseas. Our inability to access these under the program will hinder our ability to develop this technology, which will, in the very least, delay our ability to fund the project, delaying the spillover economic gain, improved environmental outcomes, and the knowledge-transfer into Australia of this cutting edge technology. Therefore, the current restrictions would work to the detriment of companies such as New Hope that undertake cutting edge R&D.

Whilst we understand the Government's reasoning for seeking to encourage activities to occur in Australia our preference would be to see more flexibility built into the system to allow companies greater flexibility in claiming for activities such as overseas testing and trialling where there are no facilities in Australia for that purpose. On this basis we see no need for an arbitrary percentage of allowable expenditure to be applied, rather we would prefer to see principles governing allowable overseas activities where companies would self-assess eligibility.

Principle 2

The Standard R&D Tax Credit will be available at a rate of 40 per cent for eligible R&D expenditure and can be carried forward where a company's income tax liability is zero.

New Hope supports this principle. In particular, we consider one rate of concessional treatment to provide greater certainty for claimants and less complexity in administration.

Principle 3

The Refundable R&D Tax Credit will be available to companies with a turnover of less than \$20 million at a rate of 45 per cent for eligible R&D expenditure.

New Hope does not have any comments on this principle.

Principle 4

Legislation for the new R&D tax incentive will provide support for the scheme's efficient and effective administration.

New Hope supports this principle. However, we believe the proposals put forward in the consultation paper relating to change in the definition of R&D add complexity to

the scheme, which is contradictory to the objective of this principle. We are particularly concerned about the proposal to limit supporting activities as all the options put forward require claimants to separately identify and cost core and supporting activities, adding significant complexity for both claimants and administrators of the program.

Minimal legislative change will assist the Government achieve Principle 4, especially retaining the same meaning of key terms (such as “innovation”, “high levels of technical risk” and supporting activities). Retaining these meanings, as established by legislation and case law, will assist claimants have certainty over the benefits arising under the new R&D incentive program.

Principle 5

The new R&D tax incentive should target R&D that:

- (a) is in addition to what otherwise would have occurred; and*
- (b) provides spillovers — benefits that are shared by other firms and the community — that are large relative to the associated subsidy.*

New Hope does not have any comments on this principle.

Principle 6

Eligible R&D activity will be defined as systematic, investigative and experimental activity that:

- (a) involves both innovation and high levels of technical risk; and*
- (b) is for the purpose of producing new knowledge or improvements.*

In order for the Government to achieve its stated objective of additionality, predictability of benefit will be key for the new R&D incentive program. To this end, changes should be minimized as any changes will induce uncertainty. The current definitions are well understood by claimants and administrators. On this basis, **New Hope do not support any of the proposed changes to the definition of R&D activities.**

The stated intent of the current R&D tax incentive is to encourage development, increase investment, promote technological advancement, encourage strategic planning and create an environment that is conducive to increased commercialisation. In addition to this, the consultation paper provides for an additional intent of redistributing support in favour of small and medium sized businesses. Our view is that the introduction of the requirement that activities have both innovation and high levels of technical risk will work against these objectives for the following reasons:

- It does not recognise that activities that only have high levels of technical risk also promote technological advancement, lead to new processes, new knowledge and lead to additional and spillover benefits to the greater community;
- For well established industries such as mining, it is often the resolution of the uncertainties and technical risk involved that leads to new opportunities rather than grand leaps in innovation. The mining industry is a major contributor to economic growth, has been a pioneer in Australian R&D and often leads the world in mining technology. R&D in the mining industry is often strong on technical risk – this change disadvantages certain industries;
- By moving away from the well-established definition and understanding of R&D, there will be increased uncertainty and subsequently future investments by New Hope on R&D projects may be reduced;
- Small companies will be impacted along with large companies with these changes.

Having said this, New Hope accepts that some changes (i.e. tightening) of the current definition may be necessary to deliver increased concessional rates and refundability. The removal of the 175% Premium Concession will, no doubt, go a long way in this regard. However, if further measures are required, New Hope's preference is that the definition of core R&D be changed to *innovation "and" high levels of technical risk* rather than limitations to supporting activities. The limitation achieved by requiring core activities to be both innovative and have high levels of technical risk, will have an implicit limitation on what activities are then supportive of these activities. No specific limitation to supporting activities is required.

Principle 7

Supporting R&D will continue to be recognised under the new R&D tax incentive but claims will be subject to new limitations.

Question 4 - Should supporting activities:

- (a) be capped as a proportion of expenditure on core R&D?*
 - (i) If so, what would be the appropriate proportion (for example, 1:1)?*
- (b) only be eligible where they are for the sole purpose of supporting core R&D activity?*
- (c) exclude production activities or dual role activities?*
- (d) only be eligible on a net expenditure basis?*
- (e) attract a lower rate of assistance than core R&D?*
 - (i) If so, what would be the appropriate rate be?*

New Hope strongly disagree with Principle 7. It is our view that the proposed restrictions on supporting R&D activities will reduce the incentive for New Hope to undertake R&D, again working against the stated intent of the program. This is due to the fact that the actual value of the incentive to companies will be reduced and the administrative costs of accessing it will increase. Companies may also reconsider undertaking projects that have a larger number of supporting activities if the available incentive for these is reduced or restricted, thus potentially reducing the amount of R&D activities being undertaken.

Our view is that the current definition of supporting activity, and in particular, the requirement for it to be for a purpose directly related to the carrying out of core R&D activities is adequate in:

- i) restricting the types of supporting activities that can be claimed through the need to demonstrate a nexus to the core R&D activities; and
- ii) still providing incentives for R&D projects that legitimately need the range of supporting activities registered in order to carry out the core R&D activities.

Take, for example, New Hope's coal to liquids project – a major innovation for Australia. Because of the uniqueness of the technology and the significant technical and environmental hurdles that must be overcome before commercialization can occur, significant testing and trialing work will be required. Any moves to limit the scope of assistance provided for supporting activities would hinder the business case for pursuing this project.

In regards to the specific proposed restrictions, we provide our comments below:

(a) be capped as a proportion of expenditure on core R&D?

(i) If so, what would be the appropriate proportion (for example, 1:1)?

This we feel is too arbitrary a measure as it seeks to apply a formula without consideration of the role the supporting activities play. It will also discriminate against certain companies and industries where a large number of supporting activities are necessary to undertake core R&D activities. This will also be administratively complex, for example, what if activities involve both core and supporting elements or where core activities are being undertaken in future years? Benefits will be difficult to predict, putting this option in contradiction with the Government's stated objective of additionality.

(b) only be eligible where they are for the sole purpose of supporting core R&D activity? or

(c) exclude production activities or dual role activities?

New Hope considers that options b) and c) are in essence the same, as they both introduce the concept of supporting activities being for the sole purpose of carrying

out core R&D activity. These options will effectively penalise companies such as New Hope that, due to the nature of their industry, need to test hypothesis in the context of production activities.

For example, the commercial requirement of New Hope's operation mean that we cannot afford to cease operations to allow for specific R&D trials to occur in a production environment. If these cannot occur at the same time then it is likely that the R&D program will be sacrificed in the long term for the short term gain of operating profits.

(d) only be eligible on a net expenditure basis?

This option will only provide incentive to companies where the R&D activities have not been successful commercially. Administratively this will add another layer of complexity as companies will need to identify/attribute recovery of costs against R&D outlay. Benefits will be difficult to predict, putting this option in contradiction with the Government's stated objective of additionality.

(e) attract a lower rate of assistance than core R&D?

(i) If so, what would be the appropriate rate be?

We maintain that no change is necessary to the definition of supporting activities nor the concessional rate these activities attract. Like the other options proposed, this option requires claimants to separately identify and cost core and supporting activities, adding to the administrative burden of claiming a R&D incentive.

However, New Hope acknowledges that one benefit option (e) has over the other options is retaining the current definition of supporting activities and the certainty this would provide claimants and administrators.

Question 5 - Should the current list of activities excluded from being considered core R&D be:

(a) amended in any way?

(b) extended to exclude certain activities from being considered supporting activities?

One of the very successful elements of the R&D Tax Concession is its broad based nature. New Hope's view is that it is undesirable to place any specific limitations on activities or industries. Activities should be excluded from concessionary treatment only by virtue of not fulfilling the eligibility requirements of the definition.

Question 6 - How should the new R&D tax incentive treat software R&D?

New Hope does not have any comments on this principle.

Conclusion

New Hope strongly implore the Government to retain the current definition of R&D activities to the extent possible. New Hope is concerned about the impact of the proposed changes to the R&D definition, especially to supporting activities, on timing of its own R&D projects and business spending on R&D generally.

Thank you again for the opportunity to provide comment on this Consultation Paper.

Yours faithfully,
NEW HOPE CORPORATION LIMITED

MJ Busch
Financial Controller and Company Secretary