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General Manager
Business Tax division
The Treasury
Langton Crescent
Parkes ACT 2600

23 October 2009

Dear Sir/Madam

Submission on Research and Development Tax Incentive Consultation Paper

We refer to the above Consultation Paper and submit the following comments regarding the proposed reforms.

Simplot Australia (Holdings) Pty Ltd (Simplot)

The Simplot consolidated group ranks amongst the top ten food and beverage manufacturing groups in Australia. Simplot manufactures, markets and sells frozen, canned and packaged foods under leading brands. Its high quality products can be found on all supermarket shelves and freezers and is served in catering facilities such as hotels, restaurants, hospitals and canteens.

Simplot products have been an integral part of Australian life for generations. From sumptuous meals on the table to quick snacks on the run, Simplot products promote Australians to eat healthy and nutritious food. These products are organised and marketed under several well known brands including Edgell, Birds-Eye, John West, Leggos, Ally, Seakist, Harvest, Chiko, I&J and are also promoted via the Simply Great Meals club.

Simplot also enjoys the number one market share in retail frozen vegetables, canned vegetables, frozen potatoes, frozen seafood and tomato paste. On average, every Australian consumes one Simplot product daily.

Simplot is now a national business with manufacturing facilities in most states and employs an estimated workforce of over 2,000 people.

As part of Simplot's strategic plan for business growth, with the acquisition activities that further Simplot's manufacturing capacities and opportunities for R&D, Simplot is constantly investing in the future growth and stability of its products, people and processes with renewed focus on innovation. All key strategies of the company have product innovation implications. Simplot has a dedicated Quality and Innovation (Q&I) team of nutritionists and food technologists based at the Chifley Park Research Centre in Mentone, Melbourne to address all aspects of new and improved product and process technologies.

Simplot's strength has traditionally been the quality of its products, and in particular the variety of its healthy and nutritious product range, including vegetables, seafood, snacks and finger food utilising high quality ingredients. The company's products are unique in flavour and nutritional profiles.

Simplot is acknowledged as a leading food innovator and the company experiments with and evaluates new and innovative products to respond to consumer needs for products that can be

Edgell

BIRDS EYE

JOHN WEST

leggo's

TOP CUT

Seakist

Harvest

CHIKO

I&J

Ally

The Home
of Australia's
Favourite Food
Brands

eaten as part of a nutritionally balanced diet and active lifestyle. Simplot also invests significant effort and resources into development of leading edge processes and technologies and bioscience development and integration.

The current R&D tax concession

Simplot has claimed the R&D tax concession for a decade. The program has delivered valuable benefits to our business over these years and provided an incentive to continue our R&D program in Australia.

However, we note that the level of government assistance under the scheme has diminished substantially since its introduction in 1986, with the R&D tax concession rate reducing from 150% to 125% at the applicable tax rates. Back then the effective benefit for each dollar of R&D investment was 24.5 cents in the dollar whereas currently the benefit is 7.5 cents in the dollar plus any premium amount that might be applicable.

This is a significant reduction in the level of R&D support for business innovation in Australia and in our view the level of assistance should not be further reduced.

Positive aspects of the proposed reforms

We consider that there are several positive aspects to the proposed reforms including:

- the proposal that location of Intellectual Property is not relevant to the determination of eligibility;
- the proposed 'refundable tax credit' for small to medium-sized enterprises at a rate of 45 per cent.

We consider that the above proposals are positive for the Australian economy and the continued encouragement of innovation activity in Australia now and in the future, even though they may not directly benefit Simplot.

Other positive aspects include:

- Above the line: We note that the proposal to allow companies to report the R&D tax credit as income above the line first put forward in *Venturous Australia* has not been addressed in the consultation paper. It is our understanding that this proposal would not involve any additional cost to the revenue and in our view, would also encourage companies to place greater focus on innovation and R&D. We would strongly encourage this proposal be further considered and implemented.
- The 'on own behalf' rules: These rules restrict entitlement to the R&D tax concession to the company in whose substantial interests the activities were carried out. In our view this is approach is now well understood and is a requirement that should be retained.

Potential Solution to Minimise the Impact of Large Scale Expenditure Claims

We are not precisely sure of the policy driver behind the proposed restrictions regarding the 'definition' and 'supporting activities'. We assume that the proposed restrictions may result from the increased cost to revenue resulting from 'large scale' R&D claims in certain industry sectors.

If cost constraint is the key driver, we propose the following solution:

- a formal 'pre-approval' process for companies *intending* to claim in excess of \$100m (CPI indexed) of R&D expenditure per annum.
- This 'pre-approval' could occur six months into the *current* financial year for the claimant company. The company would be required to justify to the relevant authority why it *intends* to claim such expenditure, and highlight the innovation or high technical risk associated with the project. The Government R&D audit team/committee would then need to deliberate upon the submission and approve or reject the R&D application. Appeal processes may also need to be formalised/revised to ensure a speedy outcome.
- If the project(s) are approved, the company would then need to capture the relevant expenditures etc. and when the year end calculations are completed, submit a final report to the relevant authority for final sign-off prior to lodgement of the R&D tax schedule with the ATO.

If the above process is implemented, we believe the cost to revenue of large scale claims would be constrained. This solution is consistent with the Government's intention to re-direct R&D support to smaller companies.

Importantly, this solution would make entirely redundant the need to restrict the 'definition' and scope of 'supporting' activities, which will have a negative impact across the wider business community. The restrictive measures proposed in the Consultation Paper will unduly impact ALL companies around Australia, and work against the Government's overall policy objectives of improving Australia's competitiveness on a world-wide basis.

As such, the restrictive aspects of the Consultation Paper would not need to be implemented.

Issues of concern

Change of R&D definition

Although there are several positive aspects outlined in the consultation paper, we question the rationale for the proposed changes to the current R&D definition and, without a very strong and compelling rationale, there is a greater risk in tampering with the definition, that it will only generate unwarranted confusion, uncertainty and unpredictability.

R&D tax incentives have been effective for us and assisted the funding of our R&D activities which has underpinned our company's growth and development. However, we are concerned that the changes proposed will adversely impact our ability to utilise the benefits of the incentives in furthering our R&D and its commercialisation.

We strongly believe that a cornerstone objective of Australia's R&D incentive should be to encourage R&D activities within Australia in order to, amongst other things, make eligible enterprises internationally competitive. Modifying and narrowing the definition is likely to have an adverse impact on encouraging investment in R&D in Australia and in today's global community, companies can choose to undertake R&D under more advantageous regimes elsewhere.

Therefore, we do not believe that any sufficiently compelling case has been made out for either the replacement of "*or*" with "*and*" in the "core" R&D definition nor for any of proposed changes to the "*support activities*" definition, most of which are arbitrary and potentially discriminatory as between industry segments.

As mentioned above, we believe that the Government's desire for revenue neutrality may be achieved through the 'pre-approval process' and the abolition of 175% premium deductions. Therefore the changes to the definition are not necessary or warranted.

Standard R&D tax credit

The proposal to replace the current two-tier R&D tax concession regime with a flat 40% deduction does result in a simpler process. However, in light of the fact that the after tax benefit of the R&D program has reduced over the years from 24.5 cents in the dollar to 7.5 cents, a proposed rate of 10 cents in the dollar is still comparatively quite low.

In our opinion, the Government's objective to encourage innovation would be better served if the after tax benefit were increased to 12 cents or more per dollar.

Notwithstanding this, even a low rate of 10% is critical to Simplot because it:

- allow us to reinvest the R&D benefit by employing additional R&D staff and developing existing staff;
- allows us to increase product innovation and investment in new technology, research and equipment;
- allow us to identify, develop and implement innovative solutions for products, processes and customer services through application of technical and quality expertise;
- allow us to acquire and develop new knowledge relating to food science, nutrition, processing methods, product development and scientific knowledge management strategies;
- adds rigour to our innovation and strategic planning program;
- drives a philosophy of innovation across our business; and
- helps us to commercialise our innovative products, remain competitive, and maintain our market leading status.

However, if the quantum of eligible R&D activities is reduced (via restrictions to the definition and supporting activities), we see a likely *reduction* in the level of Government R&D tax concession support to Simplot. Clearly, we would prefer this not to occur.

Eligible R&D Activity – Additionality and Spillover

Principle 5 of the consultation paper has proposed that the R&D tax incentive should be targeted at R&D that is in addition to what otherwise would have occurred and provides spillovers or benefits to other firms and the community as a whole which are large in comparison to the associated subsidy being provided.

Our primary concern with this proposal is that it is directed to R&D that would not have occurred but for the provision of the tax incentive. We are concerned that this is too restrictive and may have the effect of disallowing R&D activities that we currently undertake and which are eligible under the current regime. Some of the R&D we undertake with respect to new food and process developments must be undertaken whether or not it is subsidised or not.

Our concern therefore is that, if 'additionality' becomes part of the legislation, an auditor may incorrectly apply the 'additionality' principle to our R&D activities and determine that they are ineligible.

In this regard, we consider that the definitions of 'additionality' and 'spillover' are not readily measurable. There is a risk that auditors may be inconsistent in their assessment of these matters or make arbitrary decisions. This ultimately creates uncertainty in the business community as to what R&D activities will be allowed and how 'additionality' and 'spillover' will be assessed in practice.

Finally, it is our understanding that the policy objective of the R&D tax incentive regime has always been to encourage innovation by Australian Industry and increase international competitiveness. In our view, incentives should be available to all eligible R&D activities and not just those undertaken in excess of what might have been done without a subsidy.

Supporting R&D

The consultation paper proposes numerous restrictions in relation to expenditure on R&D supporting activities. We do not agree with any of these proposed limitations. In our view, the act of separating core from supporting activities in the manner proposed is artificial and will complicate the compliance process.

A better view is to allow all 'relevant' activities necessarily undertaken as part of a project that meet the criteria of R&D to be eligible to be claimed. This would also allow crucial activities such as testing, trialling, lab scale development, research and experimental development to be included. In our view these activities are fundamental to the R&D process and without them no R&D can actually occur.

If the Government's objective is to limit the quantum of R&D being claimed on support activities, there are more *targeted* alternative means to achieve this rather than limiting the scope of eligible support activities per the options in the Paper.

Core Technology

The current rules regarding 'core technology' are overly complex and difficult to apply. A simpler, more appropriate alternative would be to allow deductibility under the current capital allowance provisions for the effective life of the technology or some other reasonable period of time.

Other matters

Australian Tax Office: Unlimited amendment period

Under current law, the ATO has an unlimited time to amend R&D tax claims. This conflicts with the four year limitation for other tax adjustments (other than fraud/evasion etc). This 'unlimited time period' increases the compliance burden on Simplot, and creates potential difficulties (for example, where relevant staff may have left the company and the associated records from 6 years earlier may subsequently be difficult to locate). We recommend that the law be changed so it is consistent with the four year limitation.

Section 73CA

Section 73CA was specifically introduced to deal with syndicated R&D arrangements. The syndicated R&D provisions of the Tax Act have been repealed, thereby making section 73CA obsolete.

However, we understand that the ATO is attempting to use this section to apply to normal commercial arrangements for exploiting the R&D. This interpretation undermines the integrity of the R&D concession, which requires that companies will commercialise their R&D results.

As has been well documented by various Australian accounting bodies, we propose that section 73CA of the Tax Act be repealed.

We appreciate the opportunity to provide comments and feedback regarding the new R&D tax incentive and hope that our comments assist the Government in drafting an appropriate R&D tax incentive regime for Australian Industry.

Please contact me if you wish to discuss this submission in more detail.

Yours sincerely



Mr Callum Elder
Executive General Manager - Q&I
Simplot Australia (Holdings) Pty Ltd