Tel: +61 2 9251 4100
Fax: +61 2 9240 9821
www.bdo.com.au

Level 11, 1 Margaret St
Sydney NSW 2000
Australia

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Attention: RnDamendments@treasury.gov.au

Manager
Small Business Entities & Industry Concessions Unit
The Treasury
Langton Crescent
PARKES ACT 2600

RESEARCH & DEVELOPMENT TAX INCENTIVE AMENDMENTS
SUBMISSION ON BEHALF OF MSM MILLING PTY LTD

Dear Sir/Madam,

This submission is presented on behalf of our client, MSM Milling Pty Ltd. MSM Milling Pty Ltd (MSM) appreciates the opportunity to present this submission regarding the proposed amendments to the R&D Tax Incentive legislation. The specific matter of concern to the company is the proposed introduction of an R&D intensity test to determine the extent of taxation benefit received by non-refundable R&D Tax Offset claimant companies, such as MSM, with group turnover in excess of $20 million. Introduction of the R&D intensity test is considered to discriminate against companies in businesses / industries characterised by high turnover and low margins, as typified by an agribusinesses such as MSM conducting a manufacturing business processing an agricultural commodity such as canola seed. Should the proposed R&D intensity test be applied, MSM's likely tax benefit will fall from a constant 8.5 cents per dollar of R&D expenditure down to a range of 4 to 4.5 cents per dollar of R&D spend. As a high energy consumer in processing the canola seed, the proposed reduced R&D Tax benefit will come on top of the significant challenges associated with higher energy cost challenges the company is currently coping with.

Should you wish to discuss any of our comments, please feel free to contact me on +61 2 9240 9901 or +61 405 317 492 or Graham.Wakeman@bdo.com.au

Kind regards,

Graham Wakeman
Partner – Government Incentives

The Business

MSM Milling Pty Ltd is a manufacturer of canola oil, crushing canola seed and producing high quality oil and meal at its manufacturing plant in Manildra, in the Central West region of New South Wales. The manufacturing plant commenced in 2007 as a greenfields site comprising an integrated continuous canola oil and meal production facility. In the period since commencement of manufacturing, the company has also invested in an oil packaging facility on the site through a joint venture which distributes the canola oil both to domestic and export markets. MSM has also invested in a feed pelletising plant to create new market opportunities for the sale of canola meal. Company turnover is approximately $100 million and operation at Manildra currently employs 75 staff.

The industry is intensely competitive with typically very fine margins, meaning the product and productivity enhancements being sought through investment in new technology can have significant impacts on the financial performance of the company.

The Research and Development (R&D) Activities

Since the construction of the manufacturing facility, investment in research and development has been a hallmark of the business. The plant embodies several novel concepts in the production processes applied to the seed that have been created and refined since the commencement of operations. Whilst the production of canola oil and meal from oilseed is a mature industry, MSM have continued to invest significantly in new and improved product and process development.

The investments made by the company to embark upon research and development programmes have been major investment decisions involving many millions of dollars over several years, with no certainty as to the outcomes in terms of product and process developments and improvements. Whether the Government would consider the investment by MSM as 'business as usual' activities is a moot point. All of the research and development activities conducted by, or for the company are intended to enhance the performance of the company through creating technology the company can utilise to enhance the technical performance of its products and processes. As far as MSM is concerned, there is no 'business as usual' research and development activity being conducted. The company does not consider that there is any connection between its activity and 'business as usual' activities and therefore there would appear no justification to implement an intensity test other than to reduce the cost of the scheme.

In the case of MSM, there would appear no rational basis on which to discriminate against the company and the ratio of R&D expenditure to total expenditure would appear an arbitrary means of achieving the scheme cost reduction clearly to the detriment of MSM. The proprietors of the company are driven by the business need to improve the performance of the company through development of new technology. It is considered an essential component of operating a continuing business. The benefit that the company receives through the R&D Tax Incentive is looked at from the perspective that it is a reduction in the after-tax cost of carrying out the R&D activities. With scarce resources available to fund development activities, the proposed changes provide a very real disincentive to conduct R&D activities through increasing the after-tax cost of the activities. This is inevitably the outcome, notwithstanding the company's understanding as to the dynamic frame of reference recognising the integral role of technology development in maintaining and enhancing business performance.

In addition to the specific circumstances of MSM being a good example of the major shortcomings of the proposed introduction of the R&D intensity test, there are broader industry policy considerations that the proposed amendments offend. The technical shortcomings of the intensity test and the broader shortcomings of the proposed amendments are summarised in the paragraphs below

Need for Stability and Certainty

Following the 2016 *Review of the R&D Tax Incentive* (The Review) BDO emphasised the need to ensure that the administration and compliance burden on industry is minimised, whilst also meeting the Government's Science and Innovation agenda. The increased complexities and compliance requirements associated with identifying eligible activity and expenditure under the proposed changes to the program in our opinion are likely to offer little to no incentive for companies to access the R&D Tax Incentive program, particularly those such as MSM with a group turnover in excess of $20 million.

Furthermore, whilst the certainty that the existing program provides has led to activities that have generated new solutions and improved efficiencies for Australia, this is the second time since the R&D Tax Incentive was introduced to replace the R&D Tax Concession in 2011 that the government has introduced changes.

Industry Favouritism

The R&D Tax Incentive program has supported Australian businesses as an industry agnostic incentive for over 30 years. The program was initially established to provide support to businesses of all sizes and across all industries, with the goal of encouraging innovation and advancement.

The draft legislation introduces for the first time a number of specific provisions that specifically favour certain industries. First, the obvious example is special status afforded clinical trials, though this is not a focus of this submission.

Secondly, as outlined above, the proposed legislation applying to non-refundable offset recipients discriminates against those businesses which operate in industries characterised by high turnover and low margins (including the manufacturing, agribusiness and resources sectors) through the introduction of a new tiered non-refundable offset. This tiered mechanism will provide proportionately larger R&D benefits to those companies with a high 'R&D intensity'.

Under this tiered offset, companies with a turnover in excess of $20 million will be required to have an R&D intensity of greater than 13% to receive an offset greater than the current 38.5%. This will ultimately be a significant disincentive for companies to innovate, become more efficient and achieve sustainable growth. In our experience, only a handful of companies with a turnover in excess of $20 million could achieve an R&D intensity of greater than 13%.

Increased Level of Complexity

Despite recommendations in The Review, the proposed legislation introduces a number of measures that, due to their complexity, will act as a disincentive for investment in R&D activity in Australia, and in their current state, could also be open to manipulation including:

- The Intensity Test
    - The R&D benefit will operate on a tiered basis, which can only be calculated on a retrospective basis at year end and therefore cannot be determined in advance of conducting R&D activity. This is particularly disadvantageous to those companies which utilise the expected R&D benefit in creating business cases for upcoming capital projects; and
    - As noted in our specific response to the questions in the *Research & Development Tax Incentive Amendments* Consultation Paper, the intensity calculation formula utilises tax principals for the determination of the company's R&D expenditure, whilst using accounting principles for the determination of the total expenditure. The difference in expenditure treatment will therefore add further confusion, complexity and provide an incentive for manipulation of expenditure treatment to achieve a greater intensity.