

16 April 1999

The Secretary
Review of Business Taxation
Department of the Treasury
Parks Place
CANBERRA ACT 2600

SUBMISSION TO RALPH COMMITTEE REVIEW
IMPORTANCE OF R&D INCENTIVE

In our submission we will discuss three areas in which research and development (R&D) has affected Queensland Metals Corporation Ltd's group. These are:

1. A collaborative arrangement to develop a magnesium metal industry in Australia;
2. Meaningful incentives for small to medium entities to conduct research and development activities; and
3. Pragmatic procedures within the present sales tax system to alleviate cash flow difficulties encountered by new entities undertaking research and development.

COLLABORATIVE ARRANGEMENT

The R&D incentives offered by the Australian government have provided great assistance to Queensland Metals Corporation Ltd ("QMC") and its associated companies over the last decade.

The most prominent assistance received by QMC is the assistance provided to the Australian Magnesium Project, which is now owned by Australian Magnesium Corporation Pty Ltd ("AMC") (QMC owns 47.5%). Both the Queensland State and Commonwealth governments provided assistance to this project by way of a Collaborative Agreement. Under this agreement, the State and Commonwealth governments injected \$25 million to the project (through CSIRO) which is to be repaid during commercial operations based on production output sold.

The main risk associated with the magnesium metal project involves successfully developing the innovative technology needed to ensure the sale of output will be economically viable and have a competitive edge over the present market in both costs and efficiency.

The two major shareholders of AMC (QMC and Normandy Mining Ltd) have injected a large portion of the funds required for the project. However, without government assistance the research and development work undertaken by the Australian Magnesium Project may never have commenced or proceeded, particularly due to its high risk and capital intensive nature. This introduces a further risk of the possible loss of a valuable export industry (once commercialised) to other countries.

It is our understanding that the aluminium industry was provided with a similar incentive during the 1940's that saw the industry expand into a significant export earner for Australia which continues to provide employment opportunities for many Australians. We believe the assistance we received from the respective governments has provided us with the impetus to continue to develop magnesium metal production into an industry of that ilk.

MEANINGFUL INCENTIVES

The R&D tax concessions offered are valuable to companies conducting R&D only if the company has sufficient income to offset against available R&D deductions. Many companies, particularly those in their earlier stages, are not in a taxable position, so the available tax concessions do not offer any immediate benefit. In this type of situation, government grants provide much more assistance.

A suggestion to neutralise the cash flow problems encountered by many entities is to offer a choice between the R&D tax concession (presently 125%) or a grant (with no tax deduction available). We suggest the grant could be based on a reduced concessional rate of say 20% of actual expenditure for each fiscal year as opposed to the 45% tax saving (based on a 36% tax rate) which would have resulted had a deduction been available for 125% of the expenditure.

For example, a company incurs R&D expenditure of \$100. Under the present regime this company would be entitled to a tax deduction of \$125. However, if the company does not have sufficient income then this concession has no immediate cash benefit, and may never be a benefit. As suggested above, an alternative is to offer a grant (based on expenditure for the fiscal year) of \$20 (20% of actual expenditure). Had the company been able to utilise the R&D tax concession, the tax saving would have been \$45. The grant scenario provides a benefit to the government of \$25 (by reducing the loss of future tax revenue) as well as a benefit to the entity undertaking the R&D.

Offering some form of short term cash benefit (albeit small) to entities undertaking R&D may be more beneficial to both the government and entities restrained by cash requirements.

SALES TAX

Until recently, a company undertaking a new R&D project was able to pre-register with AusIndustry in order to claim sales tax exemptions when purchasing goods for use in R&D activities. Without the ability to pre-register, this means companies have to pay sales tax on all their purchases and then wait until the end of the fiscal year until they can register with AusIndustry and then claim a refund from the ATO for the sales tax paid. For many small to medium companies, this can have a severe impact on their cash flow and, in extreme cases, if funding is not available, closure of the project.

This is contrary to the spirit of the legislation, which was to provide exemptions from sales tax at the time expenditure was incurred. We would anticipate that the same type of anomaly will not be incorporated into the pending GST legislation.

Presently some of Australia's comparative advantages include technology, capital intensive industries (particularly large resource initiatives) and education. It is important for Australia to continue to maintain this edge and develop it further. To do this we require Australia to be able to offer incentives to entities to conduct their R&D activities in Australia rather than other countries.

The R&D tax concessions add value to Australia because they offer an incentive for companies conducting R&D in Australia to continue on and establish commercial operations in Australia if their research proves successful. That is, entities may offset excess R&D tax deductions against income generated upon commercialisation. In the long term this has many advantages for Australia including developing innovative programs that will enhance our future opportunities such as employment, new industries, additional export markets and the flow on benefits onto other areas of our economy.

Yours faithfully

QUEENSLAND METALS CORPORATION LTD