

Submission to the Treasury of the Commonwealth of Australia

Discussion Paper – Tax Incentive For Early Stage Investors



**The Multi-disciplinary Innovation and Development Association Ltd.
(MIDA)**

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DISCUSSION PAPER – TAX INCENTIVE FOR EARLY STAGE INVESTORS

We thank the Commonwealth Treasury for providing the opportunity to comment on the *Discussion Paper – Tax Incentive For Early Stage Investors*, released as part of the Australian Government’s National Innovation and Science Agenda.

We expect to see more developments in this area and hope that more investment in Australia’s great potential will be forthcoming in the future – from all levels of government and from the broader business community.

Australia must continue to diversify its economy and develop new technology across industries, from new processes, efficiencies and capabilities in traditional industries such as mining and agriculture, to entirely new technological arenas such as virtual and augmented reality, artificial intelligence, nanotechnology, to name a few.

About MIDA

MIDA, the Multi-disciplinary Innovation and Development Association, is an industry organisation that advocates for investment in innovation across all areas of science, technology and business.

MIDA advocates for the interests of small and large organisations involved in process innovation and new product creation. MIDA also serves as a policy think tank for increased investment in innovation and new technology.



MIDA provides policy submissions on behalf of its members and their respective industries. MIDA also organises its own discussion pieces, articles, events, and aims to business people and professionals from a broad cross-section of science and industry.

Since its inception in 2015, MIDA has sought to attract highly experienced individuals from a broad cross-section of the scientific community. Brief biographies about each of the contributors are found below.

MIDA would like to thank students Nicole Flax and Jonathan Djasmeini for their assistance in research and preparation of the Submission. MIDA believes in encouraging and supporting the young brilliant minds of tomorrow and this submission is testament to that.

For more information about MIDA, see our website at www.mida.org.au.

To speak to someone at MIDA about the Discussion Paper, contact MIDA at submissions@mida.org.au.



MIDA Contributors

Dr Leendert (Leon) Lorenzen

Leon is an internationally recognised researcher, rated by the National Research Foundation of South Africa. He has had over 31 years' experience in mineral processing, chemical engineering, electrochemistry, reactive systems, hydrometallurgy, waste treatment and biofuels. He is a Professor Extraordinary in Chemical Engineering and Mineral Processing at Stellenbosch University, South Africa. He has managed technology and innovation at BHP Billiton, projects and innovation at Snowden Pty Ltd and studies and projects at Mintrex Pty Ltd. His current work as executive consultant involves providing worldwide expert advice to industry, financial institutions, consulting businesses, research organisations and universities. For more information, see [Leon's LinkedIn Profile](#).

Nigel Hennessy

Nigel is an entrepreneur and highly experienced company director. He has been a founder or CEO in 13 Start-Up/Emerging companies during his career in Australia, USA and Hong Kong. He has also held a number of corporate positions at director, managing director and Chairman level for ASX listed and large-scale international enterprises. He has a Bachelor of Science (Hons) in Cybernetics and Instrument Physics with Mathematics in addition to Business and Financial Planning qualifications.

For more information, see [Nigel's LinkedIn Profile](#).

Marie Malaxos

Marie has been a professional executive in the resources sector for over 25 years, with involvement in all aspects of the development and operation of oil and gas fields including commercial and budget control, technical management and approval, stakeholder management and liaison, environmental management, health and safety management and assessment of assets for sale and purchase. Marie's past Board roles include the Fremantle Port Authority (Chair of Audit and Risk Committee) and the Australian Pipeline Industry Association. Marie is currently a Life Member of the Petroleum Club of Western Australia (former President), non-executive Director of Dressed for Success Perth, non-executive Director of MBS Environment and a WA Speedway Commissioner (Chair of Audit and Risk Committee). For more information, see [Marie's LinkedIn Profile](#)



Dr Luke Lau

Dr Luke Lau is a Senior Resident Medical Officer in Critical Care at Westmead Hospital in Sydney. He has experience in patient care and medical research relating to improving treatment procedures and technology in medical care. He has sat on numerous committees for Clinical Treatment, School of Medicine, and other community engagement bodies. Dr Lau has a strong interest in encouraging further medical research and medical technology and is keen to integrate this with other related areas of science and research.

For more information, see [Luke's LinkedIn Profile](#).

Francois Brun

Francois Brun is head of the Franksons Group, a venture capital and strategic consulting firm since 2009. His specialisations are focused on software technology, mining and property industries. He previously worked in corporate auditing and advisory since 2004 for firms such as Deloitte and Ernst & Young, in Australia, the USA and the UK. He has advised government on various policy areas relating to international business, taxation and development. He has also previously lectured in law. He has bachelor degrees in Accounting and Law, and a Masters in Law.

For more information, see [Francois' LinkedIn Profile](#).

Michael Dixon

Michael Dixon is the Director of Apexsa Advisory, a management consultancy service for clients with high regulatory exposure and political risk. Michael's professional experience spans several years across the resource industry in leadership positions integrating large, operationally complex divisions. Michael has several years government experience building technological competency, trust and reciprocity in key management and Ministerial relationships. Michael is a graduate of the AICD, and holds a Master of International Relations.

For more information, see [Michael's LinkedIn Profile](#).



MIDA's Submissions

Introduction

MIDA thanks Treasury for the invitation to the roundtable discussions prior to the submission due date. We appreciate the time limitations with the Treasury proposals and the Australian Government is keen to progress the National Innovation and Science Agenda.

Australian Innovation Company (Questions 4.1 - 4.8)

1. As a general proposition, MIDA supports a 'principle-based approach' to determining the definition of an Australian Innovation Company.
2. It is noted however, that differing perspectives may arise when considering whether a company is inherently innovative but undertakes activities that are 'excluded activities'. As the Discussion Paper suggests:

'A company that meets a specific number or configuration of these criteria will be eligible for classification as an innovation company provided they do not engage in excluded activities.'

3. This raises numerous issues where traditional or existing industries are engaged in revolutionising their current systems, technologies or methods of operating. This would also render some innovation in the suggested 'excluded activities' list as being inconsistent with the principles laid out in Page 4 of the Discussion Paper:
 - *changes the way an organisation, service delivery or process operates;*
 - *creates a new product or service that other organisations or consumers could use;*
 - *creates a new platform for the delivery of products and services;*
 - *changes the way an organisation, service delivery or process operates; and*
 - *creates a new organisational or marketing method.*
4. For example, the Discussion Paper suggests that a company engaged in 'farming or market gardening' (Point 15 of the excluded list on Page 6 of the Discussion Paper) would be ineligible even if it were engaged in developing new plant pathology products.



5. Another example is residential care nursing homes, particularly in view of Australia's ageing population., There are numerous innovative ideas in aged care technology and processes, in the machinery and systems that could benefit from seed funding. Excluding industry types will preclude new technology that could transform industry processes.
6. MIDA queries the rationale as to why the eligible entity definition is modelled on the Seed Enterprise Investment Scheme (SEIS) in the United Kingdom. Whilst not exhaustive, SEIS does provide that some activities could be accepted on the basis that they would 'usually' be accepted.
7. MIDA submits the eligible entity list be 'inclusive' rather than 'exclusive' and provide incentive for traditional industries, some of which are listed as 'excluded activities' to allow for innovation.
8. SEIS lists sectors that are typically eligible for investment scheme funding. MIDA suggests clearer criteria as to what makes an entity 'innovative' in place of a non-exhaustive list
9. MIDA suggests the use of similar or almost identical eligibility criteria to that utilised in other relevant legislative or government grant schemes, e.g. Commercialisation Australia, Enterprise Infrastructure Program and R&D Tax Incentives. This creates synthesis with the operation of those schemes as well as those under proposal.
10. MIDA notes paragraph 3 on pages 2 and 3 of the Discussion Paper, states a Capital Gains Tax (CGT) exemption from any gains from disposal of investors shares for first 10 years. MIDA submits further clarification of the wording is needed to avoid ambiguity.
11. In response to Gateway provisions (Questions 4.2 and 4.6), MIDA submits that enacting legislation requires a proportion of expenses to be above a threshold percentage. Requiring additional registration or approval to new programs would substantially discourage small business, small-cap, micro-investor or what may be called traditional 'backyard innovators' from attempting to utilise the tax incentive and gain benefit



12. MIDA supports the notion of cumulatively considering the eligibility of an Australian Innovation Company by reference to its status in other statutory schemes such as the Entrepreneurs' Programme or a status of having a patent filed.
13. Were there to be a criteria based on intellectual property registration, such as filing for patents, MIDA suggests:

'An idea that has been filed as a patent in any one jurisdiction';

in place of:

'An idea that has been filed as a patent in multiple jurisdictions.

14. MIDA notes however, that some small scale start-ups cannot afford to submit patents and therefore there would need to be either 'cumulative or alternate' means to satisfying eligibility criteria.
15. MIDA posits a possible alternative to allow a rebate to an Innovation Company undertaking a provisional patent. As part of the tax rebate or tax offset, the company could be compensated for the cost of the patent.
16. In regards to a self-assessment declaration (proposed in question 4.5), MIDA's view is that the most efficient and preferable option, particularly given the existing Anti-Avoidance regime under the Tax Administration Act applied by the Australian Taxation Office ensures deterrence from abuse and compliance of the tax incentive.
17. Additional oversight creates undue regulatory burden on investors and innovating entities to the effect of negating benefits from tax concessions in the proposed legislation.
18. MIDA notes 'excluded activities' (Question 4.7 and Method 3 generally) that companies in the proposed excluded list will simply start a new company with a view to funding it to produce legitimate innovation and investment, as is the case with the existing incentives.



19. Paragraph 4.1 on page 4, Method 1 states that under this definition, the innovation company would need to have commercialisation capability or bring to market and generate value from the idea. MIDA raises concern as to how an Innovation Company or persons involved in this innovation can know at the beginning of the process whether there will be value generated by the end of the process.
20. Science by its very nature is driven by processes and hypotheses as to a vast array of permutations and outcomes, so this is very difficult to say in the beginning of an innovative process. The outcomes depend on the process, the investors, the IP, and many other unknown variables. The reality being that at end of the day the company would need to have the effective business plans and processes in place to take the innovation further into the market. This could be something that is required as part of a cumulative process for determination.
21. MIDA queries Method 2 on Page 5 of the Discussion Paper, that a company would:

“need to meet a minimum number of set configurations of criteria to qualify”

MIDA queries the definition of the ‘minimum set’ to avoid ambiguity. Alternatively, MIDA submits that a cumulative ‘weighting’ be applied to determine what is or is not an innovative company.

22. In relation to exclusions mentioned on page 5 - Method 3, some viable companies maybe be precluded from participating in innovation, e.g. companies already receiving royalties of license fees might have the potential to further reinvest in new innovation. Restricting investors from reinvestment may dissuade new investors from investing in potentially viable projects.
23. In relation to Foreign Resident Companies (Question 4.8), the best message Australia could send to encourage overseas investment is to afford eligibility to foreign owned or foreign resident companies. There is no inherent risk to foreign companies being able to utilise this tax incentive. The dis-benefit of having capital flow back to an overseas parent



far outweighs the export potential and additional tax revenue for Australia or losing the innovation altogether

Direct Investment via an Innovation Company (Questions 5.1 and 5.2)

24. In relation to Direct Investment, MIDA views the proposals for integrity measures to prevent investors circumventing the cap are reasonable.
25. In the context of scale and Australia's economy, let alone exporting to an Overseas market, a ceiling of \$1 million investment will be met quickly and defeat the purpose of encouraging investment from overseas in a new idea, product or technology that could be exported overseas. For example, recent investment in Canva, the graphic design platform, attracted private equity investment of \$5 million, and would not have been eligible for the proposed tax incentive.
26. In terms of a qualifying company, many early stage companies such as those found in the, biotech industry, may be older than the 3 years and with zero turnover. Would these be excluded from the tax incentive by time limitations?
27. In relation to wording (where this is referred to at paragraph 4 on page 3):
 - *that an eligible Innovative Company must meet the following criteria:*
 - *was incorporated in Australia during the last three income years.*

MIDA submits further clarification of the wording is needed to avoid ambiguity – In its current form, it suggests a company cannot be older than 3 years from the date of the legislation or from the date of application to be an eligible innovation company. (MIDA understands this to be the intention of the proposed legislation).

28. In relation to the 10-year rule on share ownership, do company founders attract the same application, or are they treated by reference to their investment in the innovation company?
29. The Discussion Paper states an investor cannot hold more than 30% shares in an innovation company to qualify for tax incentive. MIDA questions the application of this rule in



circumstances of early large scale investors numbering less than two. MIDA suggests post 3 years of share issue it should be 30% from year 1 to 3. Ideally a 50% maximum is more appropriate to encourage small scale projects to have a higher concentration of investment and allow for expansion later on.

Indirect Investment via an Innovation Fund (Questions 6.1 – 6.5)

30. MIDA queries the importance and relevance of the proposal of entities type (as raised in Questions 6.2 and 6.3) and dis-allowing listed stock exchanges companies entities entitled to the tax treatment. It appears the United Kingdom's SEIS has adopted this position and Treasury's view is to adopt the same rules.
31. It is likely that qualifying start-ups would be under the income threshold for stock exchange listing. MIDA questions whether it is necessary to exempt entities that are listed on stock exchange and why this would be the case.
32. MIDAs submits that entities that are holding companies and invest in entities that are eligible under the legislation would be a means to being indirectly entitled to the tax treatment.
33. For example, some Biotech companies in Australia have recently undertaken reverse take-overs or 'backdoor listings' on to the ASX (ASX:IGS, ASX:VPC, and ASX:ICT). In some respects, they qualify however are not qualified under the proposed legislation.
34. MIDA submits there should be no restriction on any company being entitled to eligibility to the tax incentive so as to provide the least amount of regulation and the greatest amount of incentive to investors (in reference to Questions 6.2 and 6.4). MIDA notes sophisticated investors make decisions regarding innovative ideas still suffer losses from time to time. The risk is proportionate to the reward. Restricting non-sophisticated investors that opportunity seems to be against the spirit of innovation and entrepreneurship.
35. In relation to Question 6.4, MIDA believes that the existing Corporations Law and Taxation Laws provide sufficient regulation of management of companies, particularly



with reference to directors' duties and penalty provisions under the Corporations Law and anti-avoidance provisions in the Tax Laws.

Integrity Measures (Questions 7.1 and 7.2)

36. In relation to questions regarding the maintenance of the integrity of Australia's tax system, MIDA suggests addressing uncertainty in eligibility of investors and innovation companies through a register of Innovation Companies and investors after meeting required criteria subject to an ongoing compliance program
37. This would work at a practical level where registration as an innovation company or innovation fund will allow these businesses to concentrate on the innovation and not regulatory burdens of continual compliance.
38. MIDA holds concern that companies or funds might operate under the idea that they qualify and the tax time they do not – so there should be a registered list of approved companies and funds to ensure the investors invest in approved companies and funds and thus reduce risk

General comments in the broader economic context

39. Broader issues may arise given attempts by AusIndustry and the Australian Tax Office to reign in existing R&D tax incentives. MIDA notes the danger of a portion of the incentives provided to the investors will now be lost to 'Innovative' Companies claiming existing R&D Tax Incentives. Instead of funds being repatriated to the company it will be necessary for the company to find more investment from other areas (such as the one proposed).
40. As a result, the Innovative Company may be worse off under the new tax incentive. The resulting outcome may be that a struggling startup will need to chase more funding which will dilute the founder or founders' equity.

Recommendations

41. As a general proposition, the proposed legislation appears overly and unnecessarily complicated and vague in its current form. Without the benefit of seeing the actual proposed legislative provisions, it is difficult to provide a final view.



42. It would appear given what is available, that this legislation will see only some larger investors with only a domestic operation and a lack of vision to possibly attempt to undertake innovation to engage the new tax incentive. We propose the following:
43. Removal of the excluded activities list, given that tabling excluded activities would serve to discourage potential innovation in existing businesses and industries where there are opportunities to innovate;
44. A criteria-based approach should be used for determining eligibility for an Australian Innovation Company, being based on any one element, such as: successful patent application/s, acceptance into accelerator programs, threshold expenditure on innovation that are determined by regulations. Where further guidance is needed, a determination process could be undertaken by the ATO;
45. In the alternative to the above, another option would be the inclusion of a points-based weighting system to provide for eligibility to be determined, whereby self-assessment could be placed as an option with pre-approval into other programs mentioned above could also be available to obtaining eligibility. If necessary, a review or oversight function could be undertaken by the ATO;
46. Furthermore, in relation to the eligibility criteria, removal of the 3-year rule for eligibility and replaced with a possible guideline period starting from the first year of income being generated by the Australian Innovation Company;
47. Additionally, increasing the 30% threshold for ownership by Investors or Innovation Funds, particularly in view of the fact that many early stage start-ups have singular founders backing the project with their own funds, and often when larger, often sophisticated investors step in, they will do so by taking over 50% of the ownership in the business. One recent example was where the Founder retained 15% of the company and an investor would step in with considerable funds and take 85% to help fund and build the business into generating income;



48. Rather than only having an "Innovation Fund" as the proposed flow-through investment entity under the proposed legislation, a more flexible proposal could allow for existing structures or funds, such as investment trusts or Management Investment Schemes (MISs) to be regarded as "Eligible Innovation Funds provided they meet criteria for investing in Innovation Companies";
49. The other area of suggestion was in relation to the removal of the sophisticated investor requirement as this would exclude small-scale ideas backed by family members, the view being that as with the "innovation fund" point above, existing corporations and tax laws provide sufficient protection to investors.

Final Comments

50. The overarching rationale behind a lower tax-rate environment and increasing tax revenue for the Australian Government is both paradoxical and pragmatic. If Innovation Policy – Tax Incentives, Government Grants and aggregate lower taxes – changes the culture and attitude of Australians to innovation by encouraging additional investment in Australian ideas, then the nominal amount of tax revenue will increase because there will be an increase in innovative ideas, processes and products being made, developed and owned in Australia and then exported overseas, leading to a compounding increase in economic activity, which will in turn increase Government Tax Revenue.
51. MIDA would like to see more simplified, more streamlined, legislation targeted and focused towards small cap investors, providing actual reduced income tax and reduced compliance to encourage both domestic small and micro-cap startups as well as encourage overseas investment.
52. MIDA believes that all Government Initiatives should not be myopic in seeing short term revenue collection and regulation, but rather focus on long term infrastructure and investment, of which a stable, streamlined and efficient tax system is a vital and integral part in encouraging investment – both domestic and international – to continue to see Australia as a viable and profitable option for investment decisions to be made.



53. One such alternative option to applying a tax incentive would be to have a debt based fund such as the one in the United States – Silicon Valley Bank. Whether this could be something integrated into the New Tax Incentive for Early Stage Investors or a separate legislative scheme is something that could be left open for further consideration.

54. MIDA would welcome the opportunity to consult or provide further commentary on specific legislative provisions as they become available. MIDA also queries the interaction of the new tax incentive and other provisions being put forward as part of the National Innovation and Science Agenda, and their interrelation with existing tax and government grants, the concern being whether like existing legislation, it would be used to target startups more directly rather than to benefit larger multi-national corporations.

55. The other concern voiced by MIDA members is that the focus of this legislation should be on what its final and long term outcomes are. Specifically, the shift in the culture of Australians to innovate and encourage investment in new ideas and technology. The focus therefore, of the proposed legislation, should be on “innovation” and the scientific and technological benefits and not only investment and tax aspects.

56. Whilst we acknowledge that this is proposed tax legislation, but the nature and subject matter of the proposed legislation should have in its forefront the notion of simplified and streamlined eligibility criteria that encourages both innovators and investors to take opportunities, but at the same time encourage a long-term shift in attitude toward investment in innovation.



MIDA would like to thank the Commonwealth Treasury for the opportunity to comment on the first Discussion Paper of the National Innovation and Science Agenda, and we hope to have further opportunity to liaise with the Treasury as the Agenda continues to be rolled out.

If you have questions in relation to our submission, you can contact us at office@mida.org.au.

Yours Sincerely,

A handwritten signature in black ink, appearing to read 'Francois Brun', with a horizontal line underneath it.

Francois Brun

CEO & Co-Founder

On behalf of MIDA

The Multi-Disciplinary Innovation and Development Association