QUEENSLAND resources COUNCIL

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24 February 2016

Ms Jodie Wearne
Tax incentives for early stage investors
The Treasury
Langton Crescent
Parkes ACT 2600

via email: startuptaxincentive@treasury.gov.au

Dear Jodie

Thank you for the chance to provide comments on the Australian Treasury's Policy Discussion Paper, *Tax incentives for early stage investors*.

The Queensland Resources Council (QRC) is the peak representative organisation of the Queensland minerals and energy sector. The QRC's membership encompasses minerals and energy exploration, production, and processing companies, and associated service companies. The QRC works on behalf of members to ensure Queensland's resources are developed profitably and competitively, in a socially and environmentally sustainable way.

The relevance of Queensland, and QRC, to the Department's considerations is that Queensland is acknowledged as a highly prospective exploration province, endowed with abundant and diverse reserves of minerals, energy, petroleum and gas, although much of the state remains unexplored with the latest exploration technologies.

Queensland is also the acknowledged home to the Mining Equipment, Technology and Services (METS) sector. The Commonwealth Government Industry Growth Centres Initiative, intended to "drive innovation, productivity and competitiveness", has located the *METS Ignited* Growth Centre in Queensland. QRC's economic contribution data clearly shows clusters of METS companies in Brisbane as well as in regional centres like Mackay, Toowoomba and Townsville.

Innovation, invention and the application of new technology is critical for the ongoing success of Queensland's resources sector. Technology is adopted directly by mining and oil & gas companies and via the services of METS companies.

Investment, and the funding of innovation companies, the like of which are subject to consideration here, is as or more important to the resources sector as any other. QRC notes that the consultation and questions asked are broad; however we limit this submission to a smaller number of issues which are relevant to QRC's interest and where we believe our knowledge brings value.

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QRC has underway, with the support of the Queensland Government, a major initiative to foster and grow exploration and the number of exploration companies – start-ups! Exploration, and mining generally, are technology and capital intensive and both the exploration companies and the technology service providers are constantly in need of funding.

This has led us over a number of years to invest heavily in understanding the dynamics of innovation, early stage investment, and fostering an entrepreneurial start-up environment. Accordingly, this submission will first make some general comments as background and then respond specifically to those policy questions we believe relevant to our learnings and our interests.

General comments

Firstly, QRC congratulates the Government on the overall policy initiative of considering incentives for early stage investors. We believe it is progressive, well founded and should lead to improved economic outcomes. We note that this discussion paper relates specifically to tax incentives for investment into start-ups and not broader agendas relating to innovation; however, we wish to refer in part to the Innovation Statement and the broader National Innovation and Science Agenda.

QRC notes that the Innovation Statement makes no reference to the mining, energy oil & gas industries, or the resources sector generally. We consider this a major omission, and not just because the resources sector is a major contributor to the Australian economy.

In fact we draw to your attention, that the winner of the 2015 Prime Minister's Award for Innovation was granted to the inventor of a process applied in the coal industry (suggested in the discussion paper as an "excluded industry") that has earned more than $100 billion for Australia and reduced energy consumption and greenhouse gas emissions as well.

We agree with the desire to support start-ups, seeing them as instruments of innovation. However, this concept has been conflated with support for technology that is at least part communications technology – able to be accessed by "apps" and from mobile platforms. Guessing that this was not a deliberate intention, nevertheless we see the result as catering to fashion rather than substance.

It is fashionable to build mobile apps, but the resources sector is portrayed as old fashioned and not part of the "new economy", and thus excluded from this policy. Unfortunately, nothing could be further from the truth.

The resources sector is technology intensive and continuously at the frontier of innovation.

Innovation is central to maintaining Australia's comparative advantage in minerals and energy by supporting more competitive, safer and more environmentally sustainable operations. Nationally, the mining industry directly spends more than $3 billion per annum on research and development and is an exemplar of collaboration with research bodies.

There are many small companies – start-ups – that create new services to the industry, and indeed, increasingly, these operate on mobile platforms. This is illustrated by, but not limited to, the Mining Equipment and Technology Services (METS) sector, which Austmine estimates:

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- Contributes $90B in gross annual revenues
- Including $15B of exports
- Invests $4B in R&D
- Had a market capitalisation of more than $31B (at 30 June 2015)

In addition, the industry boasts 68% of firms investing in R&D and 66% exporting.

The importance of the METS sector and its contribution to innovation and economic growth has been acknowledged by the Government, when it established a Growth Centre for this sector. Innovation is rife in the resources sector. This extends from technology intensive geological assay to advanced mining and production techniques. It is the reason Australia, globally, is both a low cost producer of minerals while a high cost economy and an acknowledged leader in invention and the development of new processes.

While Google and others strive to create a driverless car, Rio Tinto has 69 driverless trucks operating 24 hours a day in the Pilbara and has also introduced driverless trains.

Queensland's *GroundProbe* now employs more than 150 people around the world, with its technology making mining safer in 25 different countries around the world. This Brisbane born and now global METS company originated in industry-funded PhD project at the University of Queensland. The technology is estimated to have saved more than 20 lives in its first years of operation.

Successful innovation policy is market-conforming, as it is market competition – not government fiat – that ultimately determines which new combinations of inputs become successful innovations. The role of government is to encourage innovation across the private sector, not to favour industries deemed to be innovation 'winners'.

Australia's comparative advantage in minerals is maintained and enhanced through continual innovation. The mining industry spends nearly $3 billion on R&D annually, or nearly $1 in $6 of all business R&D spending in Australia. In addition, expenditure on minerals exploration – an operating expense analogous to market research – was $1.6 billion in 2014-15.

As the Department of Industry, Innovation and Science[1] points out:

> *Australia's innovation and economic performance of the past decade has been dominated by the mining sector, which has … exploited its comparative advantage to generate enormous growth in investment, output and exports.*

Similarly, the CSIRO[2] notes that:

> *'Innovation has been instrumental in the development of energy and minerals resources'.*

[1] Department of Industry, Innovation and Science, *Australian Innovation System Report,* 2015, p.11.
[2] CSIRO, *Unlocking Australia's resource potential,* 2015, p.4.

The mining sector is a prolific inventor and developer of specialised technologies, with a total of 6,539 Australian mining inventions filed for patent between 1994 and 2011 by operating miners, the Mining Equipment, Technology and Services (METS) sector, and publicly funded entities like CSIRO[3]. Australian mining technology is exported globally, with patent filings overseas showing major markets include the United States, Canada, China, Japan, Europe, Russia, Brazil and Mexico.

A high level of innovation in the resources sector has traditionally been the means by which the mining industry has sought to overcome so-called 'depletion effects'. These effects include the running down of resource deposits, increased effort required to process saleable ores from extracted material, the adoption of more complex methods of extraction in expanded mines, and the extraction of deposits that are further away or deeper in the ground.

Innovation is an outcome, not an industry in its own right as some suggest.

The germ of innovation, that is invention, can come from many sources and can benefit diverse industries. We see this initiative as de facto policy to support start-ups; however, innovation, and thus this policy, cannot be limited to certain industries. Accordingly, we submit that policy should be neutral and agnostic with respect to industry and should aim to promote a level playing field.

Responses to specific questions

Section 4: Australian Innovation Company

This section seeks a definition of an "innovation company" such that it qualifies for its investors to receive the proposed tax concession.

QRC primarily supports a principles based approach. We believe this is the best means to achieve a level playing field. Almost by definition, innovation is unpredictable; therefore, rules that seek to classify eligibility will inevitably fail. It is futile to, on one hand, foster entrepreneurial spirit and on the other, limit its application. With appropriate definitions and principles, we do not believe it is necessary to have exclusions.

Q 4.1 Are there any additional principles that should be included in defining an innovation company?

We think the definitions of innovation provided are suitable and we make no additional comment except to repeat our support for a principles-based approach to qualify eligible companies.

Q 4.2 What gateway criteria would best define an eligible innovation company?

We believe that gateway criteria represent an inferior approach and we caution that what might seem appropriate criteria today, can easily change with time.

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[3] Emma Francis, *The Australian Mining Industry: More than Just Shovels and Being the Lucky Country,* IP Australia, 2 June 2015, pp. 6, 22, 30.

Q 4.3 Do these criteria met the objective of attracting investment in innovation companies without unnecessary regulatory burdens?

We believe adopting gateway criteria is likely to impose regulatory burdens but worse, will constrain investment. Ultimately, whether a business can attract investment is the test of merit, not a pre-imposed qualification relating to corporate structure and history.

In relation to proposed "Method 3 – Determination", for which we do not see a specific question, we add the following. Referral to the Australian Taxation Office (ATO), would provide an unnecessary bureaucratic process and this would be a significant disincentive to investment. Liaison with AusIndustry would only further compound this.

Mostly, investors have a wide choice of possible investments, which they assess and compare, sometimes only implicitly, on a risk-adjusted basis. Investment risk derives not only from business risk, that is, the potential financial performance of the underlying investment. It can also derive from poor management, weak governance and regulatory impositions, which include procedural difficulty in making the investment.

It is counterproductive to on the one hand provide incentives to encourage greater investment and on the other, introduce new and different forms of risk that serve as a disincentive. The magnitude of the proposed incentive is not that great that investors will be encouraged to participate, regardless of risk

Q 4.5 Are investors open to a process that involves lodging a self-assessment declaration prior to making investments, in order to assist with assessing take up and eligibility?

We believe investors would be averse to this, to such a degree that it could cause the policy to fail. We are not aware of any other investment class whereby an investor has to assume the risk of regulatory compliance on behalf of the investee entity and/or vet any conditions of eligibility. See again our comments under Q 4.3

Q 4.6 In relation to a gateway requirement that is based on approved accelerator programs, which types of organisations should be included and what qualifying criteria should be specified?

We repeat our view that it is both counterproductive and futile to seek to predetermine aspects of a company's history and operations as eligible criteria when the nature of innovation and entrepreneurship is rapidly changing and at best unpredictable.

Q 4.7 Are there any other investment activities that should be excluded?

QRC strongly opposes the principle of exclusion. We note and support the intention that this policy should not provide a means for either tax avoidance or investment in businesses and business processes that do not involve innovation. However, the principles-based approach suggested in Method 1, appropriately defined, provides the necessary solution.

For example, we agree that simple direct investment into property is not an appropriate activity to earn a tax concession but we repeat, the principles-based approach would exclude this. We bring to your attention a company called DomaCom Ltd, only recently listed on ASX. This business has invented and developed a process for allowing fractional investment into property, such that small investors can gain partial ownership of large assets otherwise beyond their reach. It also provides for secondary trading of these interests where previously this was not available.

In parts this is a financial services business and also a property and property investment business. It is highly innovative and has used technology to build this capability. The business was built prior to listing on ASX and required investment to do so.

With the proposed list of exclusions, we submit that DomaCom would not have been eligible under this policy when in fact it exemplifies the sort of company that should be supported. Likewise, we believe there are many start-ups in the resources sector that provide innovative new ways of business, and equally should be eligible under this scheme. To preclude industries such as coal and other parts of the resources sector is discriminatory; pandering to fashion rather than determining true principles to support innovation and start-ups.

Section 5: Direct Investment into an Innovation Company

We submit a general response to this section. We believe it is counterproductive to restrict investment to a class of investors, and in particular, not only to sophisticated investors. Most start-up companies, the early stage businesses the policy aims to serve, already raise funds from what is commonly called “friends and family”. Rarely are early stage investors, sophisticated investors. Thus any restriction would only create the adverse outcome of penalising, through lack of access to a tax concession, those investors who most support early stage ventures.

Section 6: Indirect Investment via an Innovation Fund

We have no comment on this section

Section 7: Integrity Measures

We provide no comment on this section except to note the following:

- The $200,000 per annum offset per investor will significantly limit the potential for abuse of the system.
- We repeat our belief that the level of concession, a 20 per cent non-refundable tax offset, is not that great relative to the risks involved in investing in early stage ventures, such as to encourage tax avoidance.
- To the extent that the policy does at the margin encourage extra investment into such businesses, partly motivated by the anticipated after-tax returns, then it is achieving its objective.

QRC would welcome the change to provide further comments or answer any questions you may have. The contact here is Andrew Barger, Director Infrastructure & Economics on (07) 3316 2502 or andrewb@qrc.org.au

Yours sincerely

Michael Roche

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