TAX INCENTIVES FOR EARLY STAGE INVESTORS

Submission to Treasury in response to the Policy Discussion Paper

February 2016

RESEARCH AUSTRALIA
AN ALLIANCE FOR DISCOVERIES IN HEALTH

ABOUT RESEARCH AUSTRALIA

Research Australia is an alliance of 160 members and supporters advocating for health and medical research in Australia. Research Australia's activities are funded by its members, donors and supporters from leading research organisations, academic institutions, philanthropy, community special interest groups, peak industry bodies, biotechnology and pharmaceutical companies, small businesses and corporate Australia. It reflects the views of its diverse membership and represents the interests of the broader community.

Research Australia's mission is to make health and medical research a higher priority for the nation. We have four goals that support this mission:

- A society that is well informed and values the benefits of health and medical research.
- Greater investment in health and medical research from all sources.
- Ensure Australia captures the benefits of health and medical research.
- Promote Australia's global position in health and medical research.

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TAX INCENTIVES FOR EARLY STAGE INVESTORS

SUBMISSION TO TREASURY IN RESPONSE TO THE POLICY DISCUSSION PAPER

INTRODUCTION

Research Australia welcomes the opportunity to provide a response to the Treasury's consultation on Tax Incentives for Early Stage Investors.

Health and Medical Research represents a large proportion of the publicly funded research undertaken in Australia. Health has been identified as a National Science and Research priority by the Australian Government and medical technologies and pharmaceuticals has been identified as an industry sector of competitive strength and strategic priority. Despite this prominence the sector suffers from many of the problems afflicting scientific research more generally, including a shortage of capital for the commercialisation of research. Research Australia welcomes the National innovation and Science Agenda and the initiatives therein, including the Tax Incentives for Early Stage Investors. Research Australia is confident that this measure will play a significant role in boosting private investment in the commercialisation of health and medical research.

Research Australia is generally supportive of the measures outlined in the Policy Discussion Paper and we have restricted our submissions to a few specific questions. We have proposed an additional qualifying criterion and believe that the offset should not be restricted to sophisticated investors. We have also made several proposals intended to improve the operation of the Scheme.

RESPONSES TO SPECIFIC QUESTIONS

Research Australia's response is restricted to specific questions raised in the Discussion Paper.

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

R&D Tax Incentive registration

Research Australia proposes an additional Gateway criterion: registration of activities with AusIndustry for the R&D Tax Incentive. To qualify, the registration should be for the financial year prior to the financial year in which the investment is made, or alternatively registration should be for *the* financial year in which the investment is made.

(Currently, registration can only be made in respect of the previous financial year, and must be made within 10 months of the end of that financial year; presenting some difficulties in relation to timing.)

This Gateway criterion should be sufficient for the investment to qualify, i.e. no additional qualifying criteria should be required.

R&D Tax Incentive registration is an objective and readily verifiable criterion, and registration for the R&D Tax Incentive is reliable evidence of a company's innovation credentials.

It is worth noting that the ATO and AusIndustry already work together in the administration of the R&D Tax Incentive Scheme and thus it should be administratively simple for the ATO to exchange and confirm the necessary information with AusIndustry when necessary.

Timing of the test for other qualifying criteria

The Policy Discussion Paper implies that the qualifying criteria listed on page 5 are required to be met at the time that the investment is made. Requiring the qualifying criteria to be met during the financial year rather than at the time of the investment would be administratively simpler and still protect the integrity of the Scheme. It will also avoid the problem of ineligibility for the offset due to timing issues in the sequence of events during a financial year. For example, an investment would be able be made in August and the company may be accepted into an approved accelerator program in December; as the qualifying condition has been met during the financial year, the investment qualifies for the incentive.

Research Australia submits that requiring the qualifying condition to be met before the investment is made is unnecessarily restrictive and that it should be sufficient that the condition (eg. participation in an approved accelerator program or Accelerating Commercialisation) has been met by the end of the financial year in which the investment is made.

Question 5.1 Are there any specific requirements that should be included within the sophisticated investor test to ensure that innovation companies are benefiting from both financial and technical/commercial support?

The Discussion Paper raises the possibility of limiting eligibility for the offset to sophisticated investors. Research Australia acknowledges the risks of investing in small innovative companies; many new small businesses fail. Despite this, eligibility for the tax offset should not be limited to sophisticated investors and the existing disclosure measures to protect investors should continue to apply.

Research Australia acknowledges that many small companies may choose not to incur the additional cost associated with making offers to 'retail' investors but the option to do should remain open to them. There is already a regime to protect investors and ensure they are appropriately informed. In particular, there are differences in the types of disclosure documents required to be given to sophisticated investors and retail investors. There is no reason why a retail investor in an innovation company or an innovation fund should be treated differently to retail investors in any other company or investment vehicle, notwithstanding the perceived higher risk of the investment.

The approach of the current investment regime requires disclosure to investors of the risks and this principle should continue to apply in respect of investment in innovation companies. If there are concerns that the tax offset may be used to market poor investments to unsophisticated investors, this issue is best managed through proper enforcement and surveillance of the existing law relating to disclosure and the provision of financial advice and taxation advice.

Research Australia submits that eligibility for the offset should not be restricted to sophisticated investors and the current disclosure regime for investments should apply to innovation companies as it does to investments in other companies. This includes allowing the offset for investments in innovation companies through Crowd Sourced Equity Funding (CSEF) platforms.

The Discussion Paper also raises the prospect of imposing conditions on eligibility *'to ensure that innovation companies are benefiting from both financial and technical/commercial support'*. Research Australia does not support such a proposal. As the Discussion paper indicates, *'the objective of the tax incentives is to direct more capital into innovation companies, to overcome the difficulties of attracting investment during the early stages and to provide the opportunity for more innovation companies to become established, successful enterprises.'* The focus of this measure should remain on directing more capital into innovation companies.

Research Australia submits that the potential for a sophisticated investor to provide technical/commercial support should be seen as an additional potential benefit rather than as a necessary condition of eligibility for the offset.

Not only does a requirement that a sophisticated investor provide investment and technical/commercial expertise narrow the pool of available capital, it also significantly complicates the offset scheme. Compliance with such a condition would be difficult to establish in the first instance and ongoing involvement would be difficult and costly to assess and could be a disincentive to invest.

Question 6.2 Should the incentive be limited to sophisticated investors in the case of investments through a qualifying innovation fund?

Research Australia refers to its response to Question 5.1.

Research Australia submits that investment in innovation funds should not be limited to sophisticated investors. Investment through innovation funds should be open to 'retail' investors subject to innovation funds complying with the necessary disclosure, reporting and other obligations imposed on other existing investment funds.

CSEF provides a valuable opportunity for small investors to identify and invest in innovation companies, and there is the potential for innovation funds to operate through CSEF platforms. The convergence of CSEF with the Innovation Fund provides a relatively low cost mechanism by which small investors can participate in investment in innovation companies while spreading the risk across a portfolio of innovation companies.

Research Australia submits that the operation of Innovation Funds through the CSEF platform would be beneficial and that Treasury should consider how an Innovation Fund could operate within the CSEF regime and what regulatory measures, if any, might be required to facilitate this. Consideration should also be given to avoiding the addition of 'red tape'.

Question 7.2 How could integrity measures be designed to attract and secure investment at the right stage of innovation without creating unnecessary red tape for investors?

As noted in response to question 4.2 above, the Policy Discussion Paper implies that the qualifying criteria listed on page 5 are required to be met at the time that the investment is made.

Research Australia submits that requiring the qualifying condition to be met before the investment is made is unnecessarily restrictive and that it should be sufficient that the condition (eg. participation in an approved accelerator program or Accelerating Commercialisation) has been met by the end of the financial year in which the investment is made.

Such an approach would minimise red tape in terms of meeting the test.

CONCLUSION

Research Australia is supportive of the proposal for a tax incentive for investors in innovative companies. This is an important measure to improve Australia’s capacity to innovate, and has significant potential to increase both economic benefits and health outcomes derived from Australia’s significant investment in health and medical research.

Research Australia submits that the offset can operate within the existing investor protection and disclosure regimes and should be available to investors in eligible companies. This is regardless of whether they are sophisticated or retail investors and whether they choose to invest through crowd sourced equity funding platforms or more traditional channels.

Research Australia welcomes the opportunity to provide further information and/or discuss any aspect of this submission further.

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