IRU’s response to the Government’s National Innovation and Science Agenda

Submission 1: Tax Incentives for Early Stage Investors

The Innovative Research Universities (IRU) supports the Government’s National Innovation and Science Agenda, with its 24 useful measures to transform Australia’s approach to innovation. The challenge ahead is for all involved to respond positively to the new incentives raising the level of industry driven research and investment in bringing research outcomes to market.

The incentives are in place: will investors respond? IRU will contribute to the development of the Strategy, looking to ensure that programs will encourage investor action and will not stifle opportunity through overly strict rules or exclusion of the as yet unconsidered.

1. Tax incentives for early stage investors

The tax incentives for early stage investors is a crucial part of the Strategy that needs to reach out to encourage a wider range of investors to engage with innovative companies in their initial expansion.

The proposed tax incentives will provide concessional tax treatment for investors through a non-refundable tax offset and a capital gains tax (CGT) exemption on investments that meet certain eligibility criteria.

At $106 million this is one of the largest components of NISA. It directly addresses long-standing concerns about the shortage of equity finance and access to additional finance for start-ups in Australia. According to a 2013 report by PriceWaterhouse Coopers¹, start-ups have the potential to contribute $109 billion or 4% of GDP to the Australian economy.

Given that currently some investors might be deferring their equity funding in start-ups to wait until this incentive is in place, there is an urgency to finalise this process as swiftly and accurately as possible to prevent a pause in overall angel investment. The ensuing legislation should allow for review mechanisms to change settings as experience suggests is required.

In this submission IRU considers:

• the breadth of investment methods relevant for the incentives;
• eligibility for what constitutes an innovation company; and
• the need to extend the incentives beyond ‘sophisticated investors’.

2. The potential investment methods

The policy paper envisages two different investment methods that will attract the tax incentives namely direct investment into an innovation company or indirect investment via an innovation fund.

There are other options that should be considered. One such possibility, which IRU member Flinders University will further detail in its submission, is to include the option of establishing a public company to create spin off companies.

3. Determining eligibility

The major challenges for this consultation is to determine the definition of an innovation company. The policy paper sets out three cascading ways a company may be shown to be eligible. These make sense but the current criteria for the second tier are not sufficient for the purpose.

• Principles-based

Adopting a principles-based approach is a sensible way forward as it allows for the setting down of base guiding principles without having a prescriptive set of rules that could potentially (and unintentionally) prohibit new innovative entities that have not yet been conceived at this point in time.

The outlined broad set of principles target the likelihood for innovation from the company along with some growth potential and likely international markets. This is broad, with least assurance from the investor that their judgment about a company will be supported by the ATO.

The principle that “an innovation company will need to pursue global or broader opportunities rather than having a focus on only local markets” might serve as an unintended barrier. Innovation tends to begin at home. Just because a company is initially targeting the local market should not be a barrier, particularly with the breadth that constitutes the Australian market. **Hence ‘broader opportunities’ should not be limited to potential for geographical spread but should encompass potential for significant expansion beyond a company’s initial activities.**

• Gateways and safe harbours

Many of the listed set of criteria currently are dependent on previous government approval through participation in another government innovation programme or other previous engagement with government. They could remain in the list but an effective set of gateways and harbours needs to focus at the common activities of innovation companies such that carrying out a sufficient set of them should create eligibility.

A better set of suitable factors needs to be created through input from the type of companies that are likely to be involved.

• Determination by the ATO

This approach allows for companies to seek a ruling from the ATO on whether a company qualifies. It is a burdensome approach that should be the last option for a company that is particularly unusual in its approach. The expectation should be that if an approach is confirmed as suitable the principles and safe harbours should be amended to permit future cases.

The ATO should liaise withAusIndustry over the potential inclusion of a company to provide an effective test against the intent of the policy.

List of excluded activities

The paper lists excluded activities targeting, among others, financial and property services. This should serve the purpose of eliminating potential inappropriate uses of the tax concessions. In attempting to exclude certain activities, it is important not to have a blanket exclusion of all potential innovative products and services. **IRU supports the approach outlined in the policy paper, which is based on the UK’s Seed Enterprise Investment Scheme.**
4. Opening the door beyond ‘sophisticated investors’

Given the inherent risk in investment in innovation companies, the policy paper questions whether direct investment should be restricted to certain investors or open to anyone with the available funds. One possibility is to limit the availability of the offset to ‘sophisticated investors’ as defined in the Corporations Act 2001 namely those earning more than $250,000 per annum or having a net worth of more than $2.5 million.

IRU is concerned that such an approach would severely limit the investment for the kind of companies that a university or a researcher might deal with or set up.

The paper is correct to raise the importance of ensuring investors are aware of the risks to their investment. However the focus of the policy is to extend the range of early stage investors, drawing in those who currently rarely become involved.

Limiting investment to ‘sophisticated investors’ creates barriers that would counter the impact that the tax concessions are intended to have, by eliminating some potential new investors drawn to the concept which the company intends to develop. This would include many who are now taking up crowd investment opportunities. Perversely these newer investors could choose to invest but without the taxation incentive – with the result that only established investors, those who least need further incentives, would be advantaged.

Hence, the IRU argues against any limit of the tax incentives to ‘sophisticated investors’.

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