

*2016 National Innovation and Science Agenda
of the
Commonwealth of Australia, Treasury Department*

Access to Company Losses – Draft Legislation

Submission Paper by



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

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DISCUSSION PAPER – ACCESS TO LOSSES

We thank the Commonwealth Treasury for providing the opportunity to comment on the *Exposure Draft – Access to Company Losses*, released as part of the Australian Treasury'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 Treasury 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 Raihan Hossain, Kimberley Grellinger, and Cecilia Tran 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. MIDA would also like to make a special mention to Ali Yaseen, Ala Al-Assadi and Sal Rahmaty for their contributions from their insights in industry.

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](#).

Ali Yaseen

Mr Yaseen has several years of experience in technology consulting and currently works in-house for a large ASX-listed company advising on strategy and growth. He also assists with their submissions on public policy issues in the Transport Law and Competition Law space. Mr Yaseen has a Bachelors of Commerce (Economics & Business Analytics) from the University of Sydney, Australia.

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

Ala Al-Assadi

Ala Al-Assadi has several years of work in the construction industry working for large construction and property development companies. Ala's approach of innovation and forward-thinking in the construction industry gives Ala a valuable insight into both business and innovation and the relationship between them. Ala's passion for innovation provides business with opportunities to create efficiencies within the construction process. Ala has a Bachelors of Construction from the University of Western Sydney.

Sal Rahmaty

Mr Rahmaty has over 15 years experience in management consulting in USA and Canada, specialising in business start-ups and business expansions. He has assisted numerous companies as director, operational manager, strategic consultant and venture capitalist. Sal has numerous degrees in business and information technology, and has taught in business schools across Canada.



Francois Brun

Francois Brun is head of the Franksons Group, a strategic consulting and venture capital firm since 2009. His expertise is in 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 Treasury on various policy areas relating to international business, taxation and development. He has also previously lectured in taxation and commercial law. He has bachelor degrees in Accounting and Law, and a Masters in Law.

For more information, see [Francois' 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 that the Australian Treasury is keen to progress the National Innovation and Science Agenda.

Background

The Australian Federal Treasury has outlined its plans for increasing access to company losses by businesses as a means to encouraging innovation, as noted on the National Innovation and Science Agenda¹ website:

- *'the current 'same business test' will be relaxed to allow businesses to access past year losses when they have entered into new transactions or business activities*
- *a new and more flexible 'predominantly similar business test' will be introduced*
- *under this 'predominantly similar business test' companies will be able to access losses where their business, while not the same, uses similar assets and generates income from similar sources.'*

Furthermore, the rationale for this plan can also be understood as:

"Loss making companies can be deterred from avoiding new business opportunities for fear that they will lose access to valuable past year losses.

The ability to offset losses against other profits is particularly important for small innovative companies because they are often cash-poor and have less diverse income streams in comparison to well established businesses.

*This measure will encourage entrepreneurship by allowing loss making companies to 'pivot', a common event on the path to commercialization typical in early state start-ups. "*²

¹ NISA website, <http://www.innovation.gov.au/factsheets/increasing-access-company-losses>, viewed 17 April 2016.

² Ibid.



Relevantly, the Exposure Draft for the legislation, will point to various aspects of the above in terms of implementation, in addition to other minor changes sought to support or supplement innovation throughout the tax system.

Submissions

1. MIDA's submissions will speak to aspects of the legislative provisions, and in addition provide critical analysis with a view to suggested outcomes of the proposed legislation, as well as possible alternatives that could be implemented with equal or greater ease.
2. MIDA raises issues in regards to the changes in the Same Business Test ("SBT") but also raises these issues in the context of the absence of any changes in the Continuity of Ownership ("COT") Test.
3. MIDA also questions the actual impact that the legislation will have on Australia's culture, psyche and attitude toward innovation

"Same or Similar" Business Test

4. MIDA submits that the criteria of the Similar Business Test, does not go far enough to promote innovation, particularly for small-cap enterprises. Principally because whilst the new test is broader, it also requires a cumulative consideration. i.e. to meet the test, the factors must be considered by way of "having regard to..." in addition to the use of the word "and" suggests more consideration to all factors, rather than an "or" requirement as the Explanatory Memorandum sets out on page 10, the factors considered are:
5. The extent to which the assets (including goodwill) that are used in its current business to generate assessable income were also used in the company's former business to generate assessable income;
6. MIDA seeks clarification on what assets are included in this test. The most valuable asset an early stage start-up has are, arguably, its founders and early employees. The nature of the business may change dramatically, as well as the product offered and the underlying capabilities. However, the human resources of the type described above, not



only provide a source of resilience, but also continuity. MIDA seeks further specification of the ‘assets’ to be included in this test, so as to prevent significant variability in its application, hence creating the level playing field desired by innovators.

7. the extent to which the sources from which the current business generates assessable income were also the sources from which the former business generated assessable income; and
8. MIDA urges the Treasury to provide clarity in regards to the ‘sources’ of income considered. In technology start-ups for example, there are several layers of the value chain, and it is arguable which the underlying source is:
 - Offering
 - Business model
 - Business capabilities (derived from 4)
 - Underlying technologies
9. Limiting the definition of ‘source’ to 1 & 2 hinders flexibility and is contrary to the spirit of the amendment. Extending the definition to 3 & 4 allows for a range of viable business models based on arguably, the most capital intensive tasks for a start-up: Development of underlying technologies and related business capabilities. In regards to:

“Whether any changes to the former business are changes that would reasonably be expected to have been made to a similarly placed business.”³”

10. MIDA urges the Treasury to rethink the ‘similarly placed business’ requirement. The Treasury must understand that innovation is by its definition unique, paradigm shifting and often misunderstood in its early stages. It is unreasonable and unwise to view these businesses through the lens of a ‘similarly placed business’, when often times, one does

³ Commonwealth of Australia, *Tax and Superannuation Laws Amendment (2016 National Innovation and Science Agenda) Bill 2016: Access To Losses*, p 10



not exist. This creates practical hindrances in accessing previous losses for bootstrapped start-ups working to create new business models to disrupt ‘similarly placed businesses’.

11. In practical terms, it is debateable how much utility any new product innovation, start-up business, or disruptive technology could actually benefit from this because of the critical element of “Pivoting” whereby start-ups change their original product offering and literally ‘pivot’ into a new direction. When this occurs it is substantially different to the “former business” and in effect all of the above criteria are insufficient to support this. This would be particularly so with “Platform Pivots”, “Business Architecture Pivots” and “Technology Pivots”.⁴

Example: XYZ Company is a mining company and its business is as a primary silver miner that extracts silver ore from its mining operations.

The main metal by-products of its mining process are Zinc (Zn), Nickel (Ni), Gold (Au) and Copper (Cu).

Another by-product achieved by a separate process, is Sulphur Dioxide (SO₂) which could be used for bleaching, fumigant and food preservatives and in purifying petroleum products.

The company uses the same source for the final products, but only some of the same initial assets, and could not have expected this new assessable income. Arguably XYZ would fail the new broader similar business test.

12. MIDA submits that However, the “Source” of both processes are the same. The assessable income generated is done so by different processes and potentially different assets.
13. The change is not necessarily reasonably expected but in terms of encouraging innovation, it is highly persuasive that the business is not similar to the original business and would in fact discourage innovation because the company would be concerned that the company’s losses would not be rolled over into the new “similar business”.

⁴ <http://www.forbes.com/sites/martinzwilling/2011/09/16/top-10-ways-entrepreneurs-pivot-a-lean-startup/#28aec16e5829>



14. As a further demonstration, Innovation.gov.au presents a practical example of how the new Similar Business Test will work.⁵

How it will work in practice

RePoly Pty Ltd has developed a way to turn algae into biodegradable plastic. It incurs large initial expenditure on manufacturing equipment. In the first three years of operation, RePoly makes a loss.

To ensure its viability, RePoly brings in an early stage (angel) investor who contributes additional capital. This results in a majority change in ownership.

After this change, RePoly seeks to expand its business in an effort to reach profitability. This expansion allows RePoly to make a profit in year four. RePoly seeks to offset its past losses against current year profits.

Possible treatment under existing law

RePoly would fail to meet the 'same business test' and access to past losses would be denied.

Possible treatment after new measure introduced

RePoly would pass the 'predominantly similar business test' because it makes use of the same assets, generates the majority of its income from the same business, and took advantage of an opportunity a similarly placed business would take advantage of. As a result, RePoly would be able to access past year losses.

Source: Innovation Australia, www.innovation.gov.au⁶

⁵ Innovation Australia website, <http://www.innovation.gov.au/system/files/case-study/Factsheet%203%20-%20Increasing%20access%20to%20company%20losses.pdf>, viewed 16 April 2016.

⁶ Innovation Australia website, <http://www.innovation.gov.au/system/files/case-study/Factsheet%203%20-%20Increasing%20access%20to%20company%20losses.pdf>, viewed 15 April 2016.



15. Therefore, it would be questionable whether the benefit of a change in the Same Business Test (“SBT”) would in fact achieve greater innovation for start-ups.

16. The Treasury must be careful to ensure this test does not enhance acquisition behaviour by large established companies. Often, loss making technology start-ups are acquired by large established companies to capitalise on their ‘user base’ through capabilities and offerings developed over decades in the larger company. This acquisition activity, whilst an attractive exit option for many entrepreneurs, does not increase competition in the medium to long run. Changes to the Continuity of Ownership Test must strike a balance between attracting investors to start-ups to enable organic growth, while not disproportionately structurally increasing acquisition activity.

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,

Francois Brun

CEO & Co-Founder

On behalf of MIDA

The Multi-Disciplinary Innovation and Development Association