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Tax White Paper Task Force  
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***Tax discussion paper: submission from the Australian Innovation and Manufacturing Incentive (AIM) group***

**About the AIM Incentive group**

The AIM Incentive is a proposed policy initiative that is backed by a group of industry leaders who are brought together by a shared concern for the future of innovation and manufacturing in Australia. The proposed AIM Incentive aims to encourage companies to commercialise IP in and from Australia. The proposed incentive would work by providing a reduction in the tax payable on profits derived from the commercialisation of qualifying IP, mainly, arising from patents or licenses to patents with an Australian nexus.

The group, supported by experts from accounting and legal firms, is primarily made up of the following industry representatives:

**AusBiotech**

AusBiotech is Australia's biotechnology industry organisation working on behalf of over 3,000 members in the areas of human health, medical devices, food technology, agriculture, environmental and industrial biotechnology, for almost 30 years. [www.ausbiotech.org](http://www.ausbiotech.org)

**Cook Medical Australia**

Brisbane-based Cook Medical Australia is part of Cook Medical; the world's largest privately-owned medical device company. [www.cookmedical.com](http://www.cookmedical.com) or <https://www.facebook.com/CookMedicalAUS>.

**Export Council of Australia**

The Export Council of Australia (ECA) is the peak Industry body for the Australian export community. [www.export.org.au](http://www.export.org.au)



**Medical Technology Association of Australia (MTAA)**

The Medical Technology Association of Australia represents manufacturers, exporters and suppliers of medical technology products used in the diagnosis, prevention, treatment and management of disease and disability. [www.mtaa.org.au](http://www.mtaa.org.au)

## Overview

The AIM Incentive group identified two questions that have particular relevance to tax policy which supports innovation and manufacturing in Australia; questions 39 and 40.

### **Question 39: Does the R&D Tax Incentive encourage companies to conduct R&D activities that would otherwise not be conducted in the absence of government support? Would alternative approaches better achieve this objective and, if so, how?**

The AIM Incentive group believes that the R&D Tax Incentive is an important mechanism to support the R&D phase of innovation. The AIM Incentive group believes it is effective in its goal of increasing the amount of R&D in Australia, encouraging companies to undertake these activities here rather than elsewhere in the world.

Australian businesses spent approximately \$29 billion on innovation in 2010-11 across all industry sectors. However, the most common expenditure categories were acquisition of machinery, equipment or technology and training, rather than in-house R&D<sup>1</sup>. Government investment is needed to encourage and better support in-house R&D by the Australian technology industry.

The Government is trying to address this through the Industry, Innovation and Competitiveness Agenda and the establishment of the Growth Centres.

The AIM Incentive group believes that whilst the R&D tax incentive encourages companies to conduct R&D activities that would not otherwise be conducted in Australia, it should ideally be part of a suite of measures that encourage both R&D and the commercialisation, including manufacturing, of the resulting intellectual property in and from Australia. Our submission to question 40 below addresses these concerns.

### **Question 40: What other taxation incentives, including changes to existing measures, are appropriate to encourage investment in innovation and entrepreneurship?**

The AIM Incentive group believes that whilst the R&D Tax Incentive is key to support R&D in Australia, once this stage has taken place the resulting innovation is vulnerable to being sold, managed or manufactured overseas due to a lack of supportive policies in Australia. The group believes that this lack of supportive policy initiatives will result in Australia not

<sup>1</sup> Australian Bureau of Statistics (ABS) (2012) Innovation in Australian Business, 2010-11, data cube: Types of Expenditure for Innovation, cat. No. 8158.0 [Accessed 20 June 2013]

realising the full community and economic benefits arising from R&D activities such as jobs, exports, manufacturing and clinical trials.

Australia is a legitimate and impressive contributor to fundamental discovery research, however this does not translate into building and enhancing a technologically innovative manufacturing base in Australia; something that the group believes is vital to secure our economic future. To illustrate the point, the 2014 INSEAD Global Innovation Index ranks Australia 10<sup>th</sup> in terms of innovation input and 22<sup>nd</sup> in terms of innovation output, but our ranking slips to 81<sup>st</sup> out of 143 economies included in the index when the input and output indices are converted to an innovation efficiency ratio.

The group believes that the government should adopt a ‘whole of life’ approach to innovation from initial R&D to manufacturing to ensure that Australia enhances its global competitiveness in innovation and manufacturing and retains a greater proportion of the community and economic benefits that arise from R&D activities. The group believes that this requires some improvements to the existing R&D tax incentive (see below), and the consideration and adoption of appropriate policies that will encourage investment into companies engaged in innovation and encourage the commercialisation and full utilisation of the resulting intellectual property in and from Australia.

### ***Changes to the existing R&D tax incentive regime***

The AIM Incentive group believes that there are a number of measures, which could enhance the current R&D Tax Incentive to increase its accessibility and effectiveness.

Currently, the 45% tax refund is only available where the claimant has an aggregated annual turnover of \$20 million or less. The group believes that whilst the availability of the tax refund acts as an incentive to smaller companies, it may unfairly restrict the ability of certain other entities to access the same benefit. For example, if a government or a foreign or local institution has a 40% or greater ownership interest in an Australian entity conducting R&D activities, that entity may be unable to access the 45% refund. The group believes that this may not be consistent with the Government’s policy objectives, particularly when such a high proportion of researchers in Australia are employed within the higher education sector. The group believes that this issue should be considered in the Green Paper.

In Australia, research has traditionally been conducted in the university sector. Approximately 60% of all Australian researchers are employed in higher education, with another 10% employed in research agencies. Only 30% of Australian researchers are employed in the business sector, in contrast with 80% in the US, 64% in Switzerland and 70% in Japan<sup>2</sup>.

<sup>2</sup> Science, Technology, Engineering and Mathematics in the National Interest: A Strategic Approach, Office of the Chief Scientist, July 2013

The current tax incentive system does not allow the 45% refundable tax offset to be claimed where exempt entities, alone or together, have a 50% or greater ownership interest in the entity conducting R&D activities. The 50% threshold applies on an aggregated basis whether or not the exempt entities are related or not. The group believes that the removal of this restriction should be considered in the Green Paper to enable universities and other institutions to invest in start-up R&D activities without endangering that entity's ability to claim the refundable tax offset.

### ***The Australian Innovation and Manufacturing (AIM) Incentive***

The AIM Incentive group believes that there is currently a lack of policy to encourage and support the commercialisation in Australia of intellectual property developed through R&D.

Intellectual property is highly mobile and intellectual property developed in Australia is vulnerable to being exported to another jurisdiction for commercialisation and/or manufacturing. Whilst the tax environment may not be the only consideration in deciding on where commercialisation and/or manufacturing activities are to take place, it is an important consideration. The group believes that this is a risk that must be addressed as a matter of urgency, as once a manufacturing operation has been set up overseas it is much harder to reverse that decision and bring that manufacturing back to Australia than it is to preserve and grow operations in Australia in the first place.

The AIM Incentive is a proposed measure to support Australian companies working in the innovation sectors to commercialise and develop their innovation into reality.

The AIM Incentive is a "patent box"-style tax incentive calculated on the qualifying IP profits generated by commercialisation. Broadly, qualifying IP profit is taxed at a lower rate (10% is suggested) with the standard corporate tax rate applied to other taxable income. Further details of the proposed AIM Incentive are included in the attached policy proposal and are available at [www.aimincentive.com.au](http://www.aimincentive.com.au)

There are currently 10 countries in the world (nine in Europe, plus China) that have adopted a patent box or 'innovation box' policy, with many more looking to introduce similar regimes in the future, including the US, which is currently considering this option.

The AIM Incentive group believes that this represents a significant threat, not only to the competitive landscape for manufacturing, but also for R&D activities and, therefore, innovation in Australia. The success of patent box schemes in stimulating local innovation and manufacturing has resulted in tensions between competing countries. For example, the result of negotiations between the UK and Germany has seen the UK Patent Box scheme amended, such that it generally only applies where the underlying R&D was also carried out

in the UK (referred to as the modified nexus approach). The group believes that the adoption of these rules by other countries may present an additional threat to Australia's ability to attract innovators as it is likely to encourage companies to locate the entire innovation chain from initial R&D to manufacturing in a single country with both an R&D tax incentive and a patent box scheme.

The group believes that introducing the AIM incentive to Australia would help to stem the flow of innovation and manufacturing offshore, helping to safeguard the future of innovation and manufacturing in Australia. The group believes that the adoption of the AIM Incentive, or a similar policy initiative, should be considered and addressed in the Green Paper.

### ***Investors***

The AIM Incentive group believes there must be a focus on making the environment right for small, medium and big business to support innovation and manufacturing in Australia with taxation being an important factor. The group believes that in order to do this the government should adopt a 'whole of life' approach to support not just the R&D activities, but also the commercialisation and manufacturing of the results and products here in Australia, and the funding required for innovation and companies engaged in it – large and small. The group believes that this is where tax initiatives, such as those adopted in Canada and the UK, which encourage private investors to fund these sorts of companies can be used to good effect in Australia.

This is something that affects not only big business but also small. Many start up or small companies are not only interested in conducting R&D in a cost effective environment, but also, given the significant costs often associated with bringing an initial idea to market, want to ensure that they remain attractive to a variety of potential investors and partners for the purposes of raising additional capital, exit, licencing deals and similar.

The UK is one country that has considered the full life cycle of innovation companies, starting from founders and initial investors all the way through the R&D cycle to the commercialisation of innovation. The UK has done so through having an R&D tax incentive, as well as its Patent Box tax regime, and also by implementing various tax incentives for these individuals. These latter measures include:

- The UK's Entrepreneurs' Relief scheme, which provides founders and initial individual investors with a reduced capital gains tax rate of 10% on the sale of all or part of a business they operate as a sole trader or business partner, or shares in a company where they owned at least 5% of the shares;

- The UK's Enterprise Investment Scheme and Seed Enterprise Investment Scheme, which provide investors with income tax deductions for shares acquired in qualifying companies, no or reduced capital gains on the sale of shares in such companies held for at least three years and the ability to offset some or all of the losses arising on the sale of these shares or the bankruptcy of the company, against other income.

It should be stressed that these are not handout schemes, but rather examples of policy initiatives to encourage investment in innovation, particularly in the early stages, and are ways to support companies involved in innovation and manufacturing. The AIM Incentive group believes that policy initiatives of this type are required in Australia to ensure that companies engaged in innovation have a greater chance of attracting required funding, particularly in the start-up phase, increasing their chances of successfully bringing innovation to market. The group believes that such policy initiatives should be considered and addressed in the Green Paper.

## **Conclusion**

Australia is competing with many other countries that the group believes are drawing well ahead. The group believes that Australia does not have any time to waste if it wants to retain and enhance its competitiveness in the innovation space; once companies commit to a particular course of action it is very difficult to change that course of action. It is our view that in order to build a smart country, further support of good tax policy for innovation and manufacturing is essential.

R&D tax incentives are not unique to Australia, and if other measures to support innovation and manufacturing are not implemented then Australia runs the risk of falling behind its global competitors. The group believes that it is important for Australia to review the initiatives being implemented in other countries in order to frame appropriate policy responses that ensure the creation of the right environment in Australia for innovation and manufacturing to thrive and grow.

The AIM Incentive group believes that true commercial innovation and R&D is about developing new products for the market and that in order to retain and encourage innovation and manufacturing in Australia, the government needs to adopt policies that recognise the whole innovation cycle from initial R&D to commercialisation and manufacturing. The group believes that these policies should also provide incentives to investors to encourage investment in companies engaged in innovation that might otherwise be regarded as too high-risk; this should ensure that such companies have access to capital in the critical early stages of innovation.

The group believes that Australia offering only the R&D Tax Incentive is no longer sufficient in a global marketplace. Simply put, the group believes that increasingly innovation will be undertaken in countries that offer a package of incentives because companies will be unwilling to forego the whole of life tax advantages and access to capital offered in countries like the UK to conduct R&D in a country that only offers an R&D tax incentive.

The group believes that as a result of patent box regimes and similar measures, over time, R&D activities will increasingly be carried out in the same country in which the resultant commercialisation would also take place. The only question is how long will this process take and which countries will be forward-thinking enough to benefit from this shift in innovation and manufacturing activities.