AusBiotech's submission to the Treasury's Discussion Paper on tax incentives for early stage investors

The Treasury
Langton Crescent
PARKES ACT 2600
Email: startuptaxincentive@treasury.gov.au.

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From: AusBiotech Ltd
ABN 87 006 509 726
Level 4, 627 Chapel St
South Yarra VIC 3141
Telephone: +61 3 9828 1400
Website: www.ausbiotech.org

Introduction

AusBiotech applauded the announcement that the Government intends to introduce a tax incentive for startup investors, which will provide concessional tax treatment for investments made in qualifying innovative startup companies with high growth potential.

Key to pre-revenue innovation companies is the need to encourage long-term private investment, an area where Australia is sorely lacking, and thereby impacting innovative industries' ability to grow at their potential rate. AusBiotech agrees that a tax incentive is an appropriate tool to use to encourage investing in young companies and that a capital gains tax break and tax offset will be attractive to investors.

AusBiotech is AusBiotech is a well-connected network of over 3,000 members in the life sciences, including bio-therapeutics, medical technology (devices and diagnostics), food technology and agricultural biotechnology sectors – including investors. AusBiotech supports the biotechnology industry, which is characterised by small and start-up companies developing new technologies. As the Australian representative body of one of the world's most innovative and globally-mobile industries, AusBiotech is acutely aware of the difference that can be made to innovation stimulation with the right policy settings.

AusBiotech supports this legitimate incentive for pre-revenue and R&D-intensive companies, however the proposed parameters to qualify for this incentive will exclude most of the biotechnology start-up community. In this regard, AusBiotech believes the policy will not meet its intent and provides the following comments and recommendations.

Biotechnology companies excluded

AusBiotech has noted in previous submissions on tax in support of such an incentive, that access to capital is critical to the success of small, start-up companies, especially for life sciences companies that have unique business model.

The proposed parameters to qualify for this incentive (specifically incorporated in the last three years; expenditure of ≤ $1,000,000; is not a listed entity) actively discriminate against companies in the life sciences sector and will exclude the majority of the biotechnology start-up community. In effect it provides capital for "capital light" companies rather than providing general access, and will exclude biotechnology companies.

In the quest to attract capital in Australia, life sciences companies are typically driven to list on the ASX or other exchanges early in their life cycle. Many would say too early. This creates challenges and costs of its own and while it ought to continue to be an option, Australia's life sciences sector would benefit from the broader options to attract capital – and an investor incentive for which this group would be eligible would provide an important component.

The life sciences model differs as life sciences companies can be pre-revenue for a decade or more before they reach marketing/regulatory approval, while needing tranches of funding at key R&D millstones. Over their entire journey to market, they may need tens or hundreds of millions of dollars for clinical trials and other research and development (R&D). Lees in the early stages of pre-clinical and early clinical and more in the later stages of clinical trials.

Companies in the situation of being still in the pre-revenue phase but have listed to listed as also pre-dividend and less liquid and less able to attract investment. An investor incentive would help in reducing this risk and make these investments more attractive – whilst adding to the overall economy.

Feedback from AusBiotech members, who are investors, is that if life sciences companies would qualify for this incentive, they would invest (more).

What is biotech's role in innovation to underpin the Australian economy?

Australia is globally competitive in terms of its technology and recently ranked fourth in the world for its biotechnology achievement and its technology is sought after. This is demonstrated by almost $2 billion worth of licensing deals and exits last year alone. Australia has the opportunity to exploit its strength by supporting early stage bio-innovation with its tax system. The industry consists of 900 biotechnology companies (400 therapeutics and diagnostics and 500 – 900 medical technology companies) and employs in excess of 45,000 Australians.

Australian biotechnology has global companies, such as CSL, Cochlear and ResMed, which have been responsible for world-leading technologies that have improved the quality of life for millions of people across the world.

Medicines and medical devices have been consistently recognised by the current Government as areas of strength in the Australian economy, which present very real opportunities for growth and success. For example, the Medicines and Medical Devices Growth Centres is among five "key growth areas where Australia excels".

Australia's biotechnology industry is poised for growth and well positioned in the global context to contribute to the economy and the lives of Australians, *but* the work on tax policy settings for start-up biotechs is critical.

Why is an investor incentive needed?

From an institutional perspective, such as a superannuation fund manager, the small scale of Australian equities and investment opportunities (on a global comparison) make it less attractive to an industry that usually places investments in a small number of large tranches, rather than many smaller investments. With the exception of major companies, Australian life sciences pre-revenue companies lack the necessary scale to attract such investment on a meaningful level.

In the current climate of structural shifts in the economy and the recognition that innovation is a key driver of productivity and therefore the economy, the use of the tax system to promote growth in innovation is sensible and enables Australia to address the market failures that currently stifle biotechnological innovation in its early stages.

AusBiotech agrees with comments in a report from the Information Technology and Innovation Foundation (IT&IF), a non-partisan US-based think tank. Its report on patent boxes (2011) said: *"From a market failure perspective, the types of innovation that ought to be supported by government are those whose benefits are larger for society than for the source firms."*

AusBiotech recommendations and comments

AusBiotech has consulted its membership, which includes life sciences companies, investors, and tax specialists, and agreed that the incentive:

1. Would broaden the base (type) of investors in pre-revenue companies;
2. Ought to be 'agnostic' to whether the company is listed or unlisted;
3. Use as eligibility criteria, the R&D Tax Incentive's refundable component (i.e. turnover of company and associates less than $20 million), which is well defined and would ensure benefit goes to pre-identified innovative companies and pre-revenue biotechnology companies;
4. Encouraging 'parking' of investments for long periods of three years or longer;
5. Be technology-neutral but allow for unique issues in biotech (such as longer development times).

Therefore, in relation to information in the Discussion Paper, the incentive would be beneficial to the life sciences start-up community if:

- The definition of an eligible company were to allow for pre-revenue companies regardless of their listed status. That is that listed companies should qualify if they meet the other criteria.
- R&D-intensive companies were allowed to be incorporated in the last six years;
- Companies that qualify for the refundable component of the R&D Tax Incentive qualify (ie have expenditure of ≤ $20,000,000).
- A "principles-based" or gateways and safe harbours" approach was taken to determine an innovation company, but the measurement was determined on the basis of its R&D intensity. The R&D tax Incentive definition could be used as a measure of eligibility.

In regard to the "sophisticated investor" measure, AusBiotech agrees that using the existing rules ($2.5 million in assets or $250k annual income) is a reasonable test and provides a simple way forward. The desire to reduce risk for investors must be commensurate with the level of compliance for companies, and the impost in the alternative (declaration documentation) is immense.

Investor incentive in context

The structural macroeconomic shift from the industrial revolution to the knowledge revolution is providing new challenges and will bring different opportunities in the future and if we can plan appropriately for these, all Australians will benefit. This Government has realised the positioning of innovation as central to jobs, productivity and a thriving economy – and we welcome this position.

Australia has excellent potential to be a nation driven by bio-innovation and our tax policy settings provide us with an opportunity to encourage growth where we want it to happen. We have a strong education system, stable government, a good regulatory regime, IP and legal environment and a proven track record in innovation. However, we need a business tax regime to support the innovation ecosystem, both at start-up phase and throughout the lifetime of a company to retain international competitiveness.

AusBiotech's submissions in recent times have made the case for tax settings to support Australia's innovation ecosystem in order for innovative industries, including biotechnology, to underpin the economy as the mining boom fades.

In addition to an investor incentive, AusBiotech argued for a broader approach to tax reform, which also included:

- Preserving the R&D Tax Incentive in-tact; and

- Complementing the R&D Tax Incentive with a preferential tax treatment of profit from locally-developed and worked intellectual property (IP), via the Australian Innovation & Manufacturing (AIM) Incentive, to incentivise the retention of economic benefits from innovation on-shore.

Summary

In summary, AusBiotech fully supports the policy intent of the proposed investor incentive, which will be significant for the private technology sectors. However, if the inclusion criteria were able to moved up the value chain to encompass pre-revenue listed companies, it could make a material difference to early stage biotechnology development in this country.

AusBiotech would be pleased to work with the Government to develop the investor incentive model further. Please contact AusBiotech's Chief Executive Officer, Dr Anna Lavelle (alavelle@ausbiotech.org), Chief Operating Officer, Mr Glenn Gross (gcross@ausbiotech.org) or Chief Industry Affairs Officer, Lorraine Chiroiu (lchiroiu@ausbiotech.org).