technology incubator

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Please find following a submission on the proposed changes to the R&D Tax Concession Scheme.

This submission has been prepared by i.lab Incubator Pty Ltd staff on behalf of its member companies.

About i.lab Incubator Pty Ltd and its members

i.lab Incubator Pty Ltd is a company owned by UQ Holdings Pty Ltd, the holding company of the University of Queensland. UQ Holdings Pty Ltd purchased i.lab Incubator from the Queensland Government in August, 2009. i.lab is a not-for-profit company managed by a Board of Directors and industry experienced staff.

i.lab Incubator delivers a range of structured and comprehensive business support, mentoring and networking, investment-ready and capital raising programs to Queensland technology based entrepreneurial start-ups less than 5 years old and employing less than 25 staff to grow their business activities to a sustainable level.

Since formation in 2001, i.lab Incubator has supported ~100 member companies, all technology based start-ups across industry sectors such as information technology and communications, cleantech and biotechnology and originating from private and university sectors. These member companies have contributed in excess of $21 million in wages during the period and in excess of 100 new highly skilled jobs. There are 20 current member companies all developing novel information technology based products which fall into software products and service models.

Such software products and services are being developed for commercial purposes to be sold into the broader customer community whether to other businesses or consumers, thus creating spillover effects into the broader economy.

General Comments:

i.Lab Incubator and its members support the existing R&D Tax Concession Scheme as being critical to start-up entrepreneurial companies expending large amounts on R&D activity to develop novel intellectual property into tangible products and services.

It is these start-up companies that are the first step in the commercialization pathway that takes novel intellectual property developed from research and ideas and translates that IP into a practical and often tangible product or service which can then be adopted by the broader economic community. R&D activities undertaken by start-up companies at this stage are focused on innovation and a large amount of technical risk as the technical development pathways are unknown and unpredictable based on existing industry knowledge.

Such start-ups are pre-revenue for several years and generally will seek capital investment from internal and external parties to support their activities until they can move to a position that generates revenues from sales.

In general the proposed changes are supported. However several issues are raised for consideration to prevent unforeseeable outcomes and to enable the proposed changes to achieve maximum impact for these types of companies as there are few other sources of grant or investment funds in this very early stage.

Issues identified:

Principle 1: Location of ownership of IP will not be relevant.

As several previous i.lab member companies have been based on IP sourced from universities, there is concern about the lifting of the ownership of university spin-out companies from 25% to 50% based on:

- The only real asset in these start-up companies is the intellectual property and that IP is generally licensed into the company to commercialise. However ownership is retained by the university or university holding company until such time as the company is sustainable and then the IP is transferred in. This consideration for that IP is recognized via a shareholding in the company and this shareholding is not realized for many years.
- These companies are separate entities undertaking risky commercial activities (outside the university core business) for which external sources of funds are sought. Generally there is no cash to support such activities from within the university and from this perspective, their parentage is irrelevant.
- First investors in such companies are generally angel investors and in some cases venture capital funds. At this stage, investors generally do not take controlling shareholding positions.
- With the proposed change lifting the ownership by a university to 50% merely raises the hurdle and renders fewer of these companies to be eligible for the R&D Tax Credit Scheme. This is not appropriate.
- Rather a total removal would be recommended to enable access to the Scheme.

It is suggested that rather than use an arbitrary level of ownership as the qualification criteria, consider using part ownership by any external and arms length (ie independent) investor as the measure.

Currently there are no current i.lab members who are developing IP sourced from universities and no specific position has been expressed. However, previous companies have suffered difficulties and support is provided for the proposal submitted by Uniseed Pty Ltd, the commercialization fund investing in start-up companies sourced from universities.

Principle 6: Changing the classification of R&D to include innovation <u>and</u> technical risk

While the overall activities of R&D in start-up companies generally involve both technical risk and innovation, there is some concern that changing the definition to include both (via the use of “and”) will create unforeseen issues with respect to R&D projects when the elements of that project are broken down.

For example, when developing a novel software product, some of the associated sub-projects (R&D based) involve established methods or principles. Not every part (of a constituent project) poses high technical risk as many will make use of established principles e.g. the methods of retrieving data and rendering it on a screen, that in themselves, are not technically risky. However, the Project overall is very innovative and thus risky, in the way it processes data, and the eventual application may not produce the design outcomes and therefore fails overall.

The current claim process requires that individual projects be described and justified as R&D. The proposed amendments that speak of technical risk AND innovative in nature could potentially exclude some projects on the grounds of elements which have low technical risk albeit they have substantial innovation risk.

It should be appreciated that there is substantial risk in inventing (innovating) a product that performs functions never before possible even if every element of the technology used is not of itself risky e.g. the product may never work as intended and the project becomes a total loss.

We would like to suggest that the "OR" be retained. Alternatively, if overall technical risk of a larger project was used as a measure rather than that of each constituent sub-project (which would also make the administrative process unnecessarily complex), then inclusion of the "and" test would be acceptable.

Principle 7: Supporting R&D

Start-up ventures undertake high levels of supporting and core R&D and generally all activities at this stage of start-up development are focused on supporting core R&D. However, establishing specific activities as “supporting” will potentially exclude them by nature of their classification and consequently have a detrimental impact start-up companies.

Activities that directly link novel R&D to it’s relevance in the market should be considered core R&D activity. This includes market research, testing, prototyping, quality control in terms of safety for users, patenting as without these activities, there will be little or no market acceptance and innovation leading to broader spillover effects will be stifled.

<u>Definition of software</u>:
A significant proportion of i.lab members are R&D software companies developing innovative software as a new product or service. Their R&D is totally involved with software development and successful outcomes have the potential to lead to broader business or consumer efficiencies. It is considered that the fact that it is software development is irrelevant and should rather should rather be treated as part of R&D as a whole.

Conclusion:

i.lab Incubator and its client companies are supportive of the existing R&D Tax Concession program and would recommend minor changes to enable start-up ventures to continue to receive tax credits or concessions within the scheme.

While it has been stated that this scheme is not a source of funding for start-up companies, it has a significant impact on the financial bottom line of those companies and restricting their ability to claim by modifying criteria would be detrimental.