

General Manager
Business Tax Division
The Treasury
Langton Crescent
PARKES ACT 2600

October 26, 2009

The New Research and Development Tax Incentive

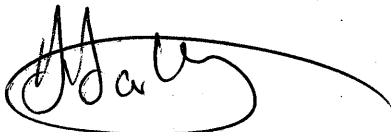
Dear Sir/Madam,

ATP Innovations is pleased to provide comment and feedback on the new research and development tax incentive program.

ATP Innovations is Australia's leading business incubator, working with entrepreneurs from the private and public sectors to commercialise technology. In 2008 our 55 client companies raised over \$33 million in capital, had revenues in excess of \$40 million, and employed more than 450 staff. The incubator is owned by four of Australia's premier universities – The Australian National University, the University of New South Wales, The University of Sydney, and the University of Technology Sydney.

ATP Innovations' response has been constructed from a series of interviews and roundtable discussions conducted with the founders and managers of early stage technology companies based in ATP Innovations' facility at the Australian Technology Park. Many aspects of the proposed program were well received by the companies; however several areas have been highlighted as of concern for early-stage R&D intensive companies. We endorse the intent to provide focus, impact and additionality for the new program, however we caution that restrictions and tightening of eligibility may impact negatively on the very stakeholders that the program is designed to assist.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'Hamish', with a large, sweeping flourish extending to the right.

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The New Research and Development tax Incentive: Industry feedback on Exposure Draft

We welcome the Government's decision to revise the R&D Tax Incentive Scheme and believe that an effective consultation process has been undertaken by the departments involved. This submission is in response to the exposure draft of the Tax Laws Amendment (Research and Development) Bill 2009 published on 18 December 2009.

This response is based on an extensive feedback from our current clients and our own experience working with over 100 small to medium sized technology companies at ATP Innovations. The general profile of these companies is;

- Commercialising emerging technology
- Across IT, biotechnology/medical device and engineering
- R&D as the primary activity (>75% of all spend)
- Revenue below \$20million
- Small profit, breakeven or pre-profit/revenue
- Accessing the R&D incentive scheme between 1 – 5 years

In general, the proposed Amendment will continue to support R&D activities in small technology companies and the reforms could increase the incentive for small R&D technology companies compared to the existing Scheme.

There is one area in the exposure draft that will negatively impact one important class of R&D companies and which we would strongly recommend is changed namely the **Ownership Threshold by Tax Exempt Entities**.

Under the proposed legislation, companies with over 50% ownership (increased from 25%) by tax-exempt entities, such as research institutes, are NOT eligible for the new R&D tax credit. Many early stage R&D companies where the IP has originated in a research institute, the institute will retain greater than 50% of the "spin out" in the first few years. Therefore, these companies will NOT benefit from the R&D incentive even though to all intents and proposes they are the same as a company where the intellectual property that has NOT originated from a government funded research organisation. These same entities (research institute spinouts) are also NOT eligible for government funding such as NHMRC and ARC because of their ownership structure. Furthermore, many early stage venture funds (e.g. Medical Research Commercialisation Fund (MRCF), Trans Tasman Commercialisation Fund, Stone Ridge Ventures and Uniseed) are structured as unit trusts. These funds do not take a controlling equity position (greater 49%) in start-up investee companies. These funds have invested in many spin outs from research organisations. These start ups have been excluded from the R&D tax scheme until the Company has gone through several funding rounds and the tax exempt entity (the research institute) has been diluted to below the threshold.

Another issue with this part of the legislation, is that a company can convert from a wholly owned research organisation entity to a joint owned spin out any time *during* a financial year. The change in ownership is generally triggered by private funding coming into the company. Under the existing and proposed Legislation, the “new” spinout company regardless of being eligible and incurring R&D expenses would not qualify for the R&D tax scheme until the following year. This timing issue has the potential to significantly disadvantage Australian early stage spinouts in their first months of operation.

Our recommendation: The Government changes the exemption to increase the proportion of ownership of tax exempt entities (ie research institutes) from 50% to 80% and introduce a revenue cap of \$1million. The timing issue be addressed to recognise that a company can convert from a wholly owned research organisation entity with R&D spend during a financial year. And regardless of when the entity has changed ownership, the spending from the time of ownership change should be eligible for the R&D tax scheme .

An example of one of these companies is provided below.

Elastagen Pty Ltd

Elastagen Pty Ltd is medical device company developing intellectual property originating from the work of Professor Tony Weiss in the School of Molecular and Microbial Biosciences at University of Sydney. Professor Weiss is considered a world leader in his field. He has several granted and pending patents in the area of recombinant human tropoelastin and its formulation into synthetic human elastin (see below for more details on elastin).

The University of Sydney with the assistance and funding from two leading venture capital firms (GBS Ventures and Brandon Capital) created a company to commercialise an elastin based product for the aesthetics market – a \$35billion market.

Elastagen, the operating company, came into being in July 2008 when The University of Sydney granted it an exclusive license and the Series A funding round was finalised. Elastagen has a strong commercial agenda, progressing their lead product by:

- i) refining the science, manufacturing and production process of product for clinical market;
- ii) finalising the regulatory path to key markets in US and EU;
- iii) conducting animal trials for safety and efficacy;
- iv) building alliances with leading dermatology clinics in the US and EU to position the company for clinical trials.

With the license and funding Elastagen changed its ownership and the University of Sydney had less than 25% equity as of August 2008. However, for the financial year 2008/09 Elastagen was NOT eligible for the R&D Tax Incentive Scheme as the University of Sydney had greater than 25% equity during the first 6 weeks of the year only. So, despite spending \$750,000 on R&D activities in the 2008/09 year Elastagen was not able to benefit from this scheme and missed out on a potential \$250,000 from the Government for further R&D work. For Elastagen and its investors, cash flow is critical and reduced access to funding increases the pressure to find alternative funding sources further down the track. For high risk ventures like Elastagen, these sources are too often offshore. Elastagen is an example, where Australia risks losing valuable IP and commercial opportunities to international investors too early in the value chain.

About Elastin

Elastin is needed wherever the body needs elasticity and resilience. Elastin helps our arteries to expand and contract with every heartbeat, our lungs to fill with air, and elastic ligaments to spring into life. Elastin also provides the skin with its ability to stretch. As we age our bodies stop producing Elastin, making it more difficult for the skin to stretch and stretch back, and therefore contributing to the sagging of the skin and the appearance of wrinkles and stretch marks. The protein, Tropoelastin, is a natural protein made in elastic tissues, which when joined together forms Elastin. Elastagen specializes in the production of a highly purified human form of Tropoelastin and its formulation into human Elastin. The Elastin produced by Elastagen is a synthetic version of that found in a newborn baby's skin, with the look and feel of natural Elastin.