



4 February 2010

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

Dear Sir/Madam,

**Submission on new R&D Tax Incentive**

Please find the attached submission from the Medical Research Commercialisation Fund (MRCF), Brandon Capital Partners (Brandon) and the Association of Australian Medical Research Institutes (AAMRI) with our feedback on the exposure draft of the Tax Laws Amendment (Research and Development) Bill 2009 published on 18 December 2009 ("the exposure draft").

Yours sincerely,

A handwritten signature in black ink, appearing to read 'Chris Nave'.

Dr Chris Nave  
Principal Executive  
MRCF

Managing Director  
Brandon Capital Partners

A handwritten signature in black ink, appearing to read 'Stephen Thompson'.

Dr Stephen Thompson  
Principal Executive  
BBF1 IIF Partnership

Managing Director  
Brandon Capital Partners

A handwritten signature in black ink, appearing to read 'Robert M. Graham'.

Prof Robert Graham  
Chairman  
AAMRI

Director  
Victor Chang Cardiac Research  
Institute



## **MRCF, Brandon and AAMRI submission on the Tax Laws Amendment (Research and Development) Bill 2009**

### **Introduction**

The Medical Research Commercialisation Fund (MRCF) is a \$30 million dedicated early-stage, proof-of-concept and pre-seed investment fund for medical discoveries coming from twenty seven of Australia's leading medical research institutes and their related research hospitals. Brandon Capital Partners (Brandon) is the Fund Manager of both the MRCF and the BBF1 IIF Partnership, a \$50 million venture capital fund licensed under Round 3 of the Commonwealth's Innovation Investment Fund programme. The MRCF and BBF1 have in the last 2 years created and supported several early stage R&D companies, securing vital jobs. The Association of Australian Medical Research Institutes (AAMRI) represents thirty seven independent, not for profit medical research institutes across Australia engaged in innovative medical research, much of which may lead to novel treatments for unmet medical needs.

The MRCF, Brandon and AAMRI welcome the Government's initiative to reform the existing R&D Tax Incentive. As stakeholders engaged in R&D, and hoping to bring about the commercialisation of novel Australian medical research discoveries, we are broadly supportive of the proposed changes. We have previously provided a submission in response to the Consultation paper of September 2009.

This submission is in response to the exposure draft of December 2009 and its intention is to provide specific input around some of the points of the proposed legislation, particularly where they impact the life science R&D / commercialisation of medical research sector. We are committed to ensuring that the new R&D Tax reforms create an environment which is supportive of the commercialisation of innovative Australian health and medical research that we and our members are engaged in on a daily basis.

### **1. Ownership threshold by tax exempt entities**

Under the legislation proposed in the exposure draft, the new refundable R&D Tax Credit will be open to companies with up to 50% ownership (increased from 25%) by tax-exempt entities, such as medical research institutes. It is, however, in our experience that many early stage, high tech, R&D based start-ups will still not be eligible for the R&D tax credit in their crucial formative pre-seed and seed stages even though the ownership threshold for exempt entities has been increased to 50%. In most medical research institute, or university, spin-outs / start-ups the exempt entity (institute or university) often owns greater than 50% of the equity after the first (seed) round of investment – particularly when the tranching of investment payments is taken in to consideration. Furthermore, these start ups are not eligible for "public support" through other Commonwealth funded programs (e.g. from the ARC, NHMRC). We maintain that there is a case for removing this ownership threshold R&D start-ups spun out of Australian Medical Research Institutes and other Publicly Funded Research Agencies. This exemption could be conditional on their turnover being less than \$1 million to make sure it was targeted at very early stage R&D start-ups.

#### *Recommendation:*

- *That the ownership threshold for tax exempt entities is either abolished (or raised to say 80%) for R&D start-ups, with a turnover of less than \$1 million, spun out of Australian Medical Research Institutes and other Publicly Funded Research Agencies.*

If the former proposal is not acceptable a second point for consideration in this respect is that most of the early stage venture funds that are currently supporting the commercialisation of Australian Intellectual Property by investing in new start-up companies (e.g. the MRCF, Trans Tasman Commercialisation Fund, Stone Ridge Ventures and Uniseed) are structured as unit trusts. This means that these funds never wish to own controlling (i.e. greater than 49%) equity stakes in any of their start-up investees (as a >50% ownership by a trust in a company causes the investment trust to be taxed). Given these funds are often the first investors in new R&D based start-ups an increase in the ownership by tax exempt entities to at least 51% would help ensure these start-ups are eligible for the R&D tax credit. This would have minimal cost impact on this entire programme for the Commonwealth.

*Recommendation:*

- *Alternatively, that this tax exempt ownership threshold is raised from 50% to 51% to facilitate investments made by early stage commercialisation/venture funds structured as unit trusts.*

## **2. Clarity regarding eligible core R&D activity**

The apparent exclusion of a number of activities from being either core or supporting activities, via the repurposing of the former s73B(2C) of the Income Tax Assessment Act 1936 (ITAA 1936). We believe that this change, while having obvious negative consequences for the computer science and information technology industries in Australia, may also have, presumably unintended, consequences, including that:

- a) s355-35 (2)(l) could be open to an interpretation that might render clinical trials ineligible as later trials are, in part performed, for regulatory requirements of the Therapeutic Goods Administration and equivalent international bodies;
- b) s355-35(2)(o,p,q and r) which will result in the exclusion of the majority of IT related R&D from obtaining support under the program.

*Recommendations:*

- *Redraft s355-35(2) to clarify those activities which are intended to be excluded.*
- *Remove or redraft the specific exclusions on computer software to ensure that genuine R&D undertaken that is information technology related is supported by the R&D tax credit program going forward.*

## **3. Timing of R&D the Tax refund:**

According to the exposure draft start-ups can only access refunds after their tax assessment is completed. This presents very early stage start-up companies with a significant cash flow challenge; indeed they may not have the cash to be able to continue as viable entities long enough so as to claim their refund. If credits / payment could be preapproved in a quarterly online registration of claims system small start-ups would be able to manage cash flow and investment in a significantly more confident manner.

*Recommendation:*

- *Small start-ups, with turnover less than \$1 million, should be able to claim their R&D tax refunds on a quarterly basis, perhaps in conjunction with their BAS statement. This would be in line with the proposals set out in the Venturous Australia report, published in September 2008.*