Government's National Innovation and Science Agenda: an update

30 November 2016

In brief

It has been nearly a year since the Government released its National Innovation and Science Agenda (NISA) and in that time, significant progress has been made by the Government to deliver on its agenda. The NISA contains various measures designed to develop a culture of entrepreneurship and innovation in Australia to drive ideas that aim to create business growth, local jobs and global success. Part of the agenda includes matters that relate to changes in Australia's tax system, including the provision of new tax breaks and changes to the tax law to address bias against business that take risks and innovate.

This article reflects on the current progress made by the Government to deliver on the main tax aspects of NISA.

In detail

The NISA was released on 7 December 2015 by the Prime Minister, the Hon Malcolm Turnbull MP and the then Federal Minister for Industry, Innovation and Science, the Hon. Christopher Pyne MP. The aim of the agenda is to "create a modern, dynamic, 21st century economy for Australia".

Much progress has been made by the Government in implementing the framework to further its plan with some of the proposals announced already enacted.

The following table summarises the key tax-related aspects of the agenda that have been announced and their current status.

Measure	Status
Improving the effectiveness and integrity of the R&D Tax Incentive programme	Review of the R&D Tax Incentive Report was released on 28 September 2016. Government is expected to finalise its response before the end of March 2017.
Tax incentives for early stage investors	New law (enacted by Tax Laws Amendment (Tax Incentives for Innovation) Act 2016 on 5 May 2016) applies from 1 July 2016
New tax arrangements for venture capital investment	New law (enacted by Tax Laws Amendment (Tax Incentives for Innovation) Act 2016 on 5 May 2016) applies from 1 July 2016

Improving Employee Share Schemes	Not yet law (exposure draft legislation and a Discussion Paper released for consultation on 26 October 2016).
Increasing access to company losses	Not yet law (exposure draft legislation released for consultation on 6 April 2016).
Intangible asset depreciation	Not yet law (exposure draft legislation released for consultation on 1 April 2016).

Improving the effectiveness and integrity of the R&D Tax Incentive programme

In launching the NISA last year the Government committed to undertaking a review of the Research and Development (R&D) Tax Incentive programme. A Review was conducted by a Review Panel, chaired by Mr Bill Ferris AC (Innovation Australia), Dr Alan Finkel AO (Chief Scientist) and Mr John Fraser (Secretary to the Treasury), which was asked to identify opportunities to improve the effectiveness and integrity of the programme, including how its focus could be sharpened to encourage additional R&D.

On 28 September 2016, the report from the Review was released by the Minister for Industry, Innovation and Science. The Review Panel found that while the programme is an important investment in a prosperous future for Australia, it falls short of meeting its stated objectives of encouraging additionality and research spillovers. The Review has made six recommendations including introducing a collaboration premium of up to 20 per cent for the non-refundable tax offset, imposing a cap of $2 million on the amount of the refundable offset and an intensity threshold for recipients of the non-refundable component such that only R&D expenditure in excess of the threshold attracts a benefit.

Following further consultation, the Government is expected to release its final response as part of a broader NISA, due by March 2017.

New tax incentives for early stage investors

The Government acted quickly to have new law enacted to apply from 1 July 2016 to encourage new investment in Australian "early stage innovation companies" by providing tax incentives for investors.

Specifically, a qualifying investor in such companies can obtain:

- a non-refundable carry forward tax offset of up to 20 per cent of the amount paid for their qualifying investment, and
- a capital gains tax exemption for their qualifying investment that is continuously held for at least 12 months and less than ten years.

In broad terms, an Australian-incorporated company will qualify as an Australian early stage innovation company if it is at an early stage of its development (the early stage limb) and it is developing new or significantly improved innovations with the purpose of commercialisation to generate an economic return (the innovation limb).

In practice, issues have arisen where a company is unable to satisfy the 100-point innovation test to satisfy the innovation limb and instead reliance is placed on a principles-based test.

Given the speed with which the legislation was enacted, it is likely that some amendments will need to be made to clarify certain aspects of the new rules.

New arrangements for venture capital investment

Amendments have also been enacted to amend the Early Stage Venture Capital Limited Partnership (ESVCLP) and Venture Capital Limited Partnership (VCLP) regimes to improve access to venture capital investment and make the regimes more attractive to investors.

These amendments, which apply from 1 July 2016, provide an additional tax incentive for limited partners in new ESVCLPs, relax restrictions on ESVCLP investments and fund size and clarify the legal framework for venture capital investment in Australia. The main changes include:

- a non-refundable carry-forward tax offsets for limited partners in ESVCLPs, equal to up to 10 per cent of contributions made by the partner to the ESVCLP during an income year
- an increase in the maximum fund size for ESVCLPs from $100 million to $200 million
- the requirement that an ESVCLP divest an investment in an entity once the value of the entity's assets exceeds $250 million has been removed, but with restrictions on tax concessions for such investments, and
- entities in which a VCLP or ESVCLP has invested (the investee entity) are allowed to invest in other entities, provided that after the investment the investee entity controls the other entity and the other entity broadly satisfies the requirements to be an eligible venture capital investment.

The Government has also conducted consultation in May this year on the best way to ensure that investors in FinTech start-up activities can be eligible for venture capital tax concessions.

Improving Employee Share Schemes

By way of background, where certain conditions are met, there are tax concessions for incentives provided by employers under an Employee Share Scheme (ESS).

The Government intends to make it easier for small business or start-up employers to provide such ESS incentives by amending the Corporations Act by removing the requirement for the Australian Securities and Investment Commission to place eligible ESS disclosure documents of certain start-up companies on the public register.

Although comments on exposure draft legislation released on 26 October 2016 were due to be made by 2 November 2016, at the time of writing the relevant amending law has not yet been introduced into Parliament.

A consultation paper containing a number of questions about further measures which could be taken in future to make ESS more user friendly was also released, with submissions closing on 7 December 2016.

Increasing access to company losses

The Government proposes to improve access to losses by supplementing the existing same business test (SBT) with a new, more flexible 'similar business test'. This measure is intended to encourage innovation by allowing loss-making businesses to seek out new opportunities to return to profitability.

Under the current law, a company that has changed majority ownership must satisfy the SBT to access past year tax losses. This may mean that a company that receives new equity investment may be discouraged from innovating or changing its existing business activity unless and until it has recouped its prior year losses. Under the proposed law, a company that has undergone a change of ownership or control, may be able to access prior year losses if it passes the similar business test.

The proposal as announced is intended to apply broadly to tax losses made by companies for income years beginning on or after 1 July 2015. In our submission to the exposure draft legislation released for comment on 6 April 2016, PwC has encouraged the Government to consider extending the application of the law so that it could apply to losses that are sought to be deducted or applied in income years commencing on or after 1 July 2015, regardless of the year in which the loss was incurred.

Although such a proposal goes some way to reform the current SBT, arguably more could be done to rewrite the SBT so that it is simpler and more efficient.

Intangible asset depreciation

The Government announced that it will amend the tax law to allow taxpayers the choice to either self-assess the effective life of certain intangible depreciating assets or use the statutory effective life for those intangibles. Although this proposal is to apply to intangible assets which are first held on or after 1 July 2016, at the time of writing, following consultation on exposure draft legislation released on 1 April 2016, the amending law is not yet enacted.

Under the current enacted law, intangible depreciating assets must be written off for tax purposes over a legislated number of years, depending on the nature of the intangible (for example, in-house software can only be written off over five years).

The proposed change to provide a mechanism for taxpayers to self-assess the effective life of intangible depreciating assets is welcomed and recognises that intangible assets add 'real value' to more businesses in today's environment. However, it must be acknowledged that the intangible asset depreciation rules in other jurisdictions are more extensive and as such remain a point of distinction for an Australian businesses seeking an 'innovation advantage' when it comes to the depreciation of intangible assets.

The takeaway

The release of the Government's NISA plan marked an exciting phase in the Australian Government's renewed drive to develop a culture of entrepreneurship and innovation in Australia. As identified, significant progress has been made by the Government to further its NISA plan however there is still more work to be done to ensure that the overall objective of better aligning the tax system to support innovation and entrepreneurships is achieved.

Let's talk

For a deeper discussion of how these issues might affect your business, please contact:

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