

Three Suggestions for Improving Funding for Australia's Innovation Economy

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Summary

This document is a submission to the Senate Economics References Committee by Greg Baker of the Institute For Open Systems Technologies Pty Ltd.

My background to writing this admission is that I have worked with a large number of start-up companies as well as having been a research scientist at CSIRO.

My submission consists of three observations:

- The role of superannuation in innovation.

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- The tax implications of redundancy payouts versus commercialisation spin-offs.
- Some subtle suggestions around the R&D tax credit and offsets

You will no doubt also receive a submission from Peter Cooper who is as close to a spokesperson for the start-up community as exists in Sydney. He will supply some detailed discussion on how some minor changes to taxation (with no loss of revenue) could make life easier for start-up founders. He calls this “stopping the geek tax”. Let me emphasise how important this is, as it is a crucial step in commercialisation of any emerging technology. He has thought this through and received very good counsel on it. It needs to be taken seriously. I refer to it in a few places in this submission.

1 Superannuation

One of the problems faced by the bodies funding CSIRO, NICTA and the universities, etc. is that we essentially have the public sector trying to make assessments about the commercial and scientific value of units of research and development. While this is a reasonable approach for the assessment of *scientific* value, it really makes very little sense for assessing commercial value.

At the same time, we have the situation that superannuation funds are quite short of long term investment opportunities in the Australian market. The closest we have to an investment fund dealing with science and technology would be Loftus Peak; but even they are only investing in listed technology companies.

I think there is a mismatch here because of a chicken-and-egg problem. It is not worthwhile investing funds in science, technology and engineering innovation because the overheads of setting up such a fund overwhelm the returns that could be made from a small specialist fund. And until such a fund exists, no-one knows what the returns will be like, so no-one will commit to invest to turn that small specialist fund into a larger one.

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If we (for example) were to **mandate 0.1% of all superannuation funds had to be invested in innovation** this would correspond to well over a billion dollars. The Australian economy would be substantially transformed by this investment. It would become worthwhile for many actors to set up specialist funds assessing the commercial potential of new developments. As superannuation funds are audited annually anyway, this 0.1% requirement would not impose a substantial additional administrative overhead.

From the other side of the funding problem it would become much cheaper and simpler for a university research or a CSIRO scientist to access funds: if there is some commercial value to some piece of research, there will be a much larger pool of funds available searching for something to invest in. Research funding for something with commercial potential will not be a problem.

Practically speaking, it would have to be brought in slowly, with perhaps a grandfathering of superannuation wealth prior to 2014. Also, the rules around what qualifies as an innovation investment would need to be defined. My best stab at this is:

- Anything run by an accredited research organisation
- A technology start-up, as per the definition that Peter Cooper has written up for his “Stop the Geek Tax” advocacy.
- Any organisation whose R&D tax concessions or rebates are greater than (say) 10% of their revenue.

While it is doubtful that any superannuation fund today is bankrolling the next pharmaceutical wonder drug, there is no reason that they couldn't. It is an investment with an appropriate lifetime and size to interest a superannuation fund. I think this could happen with some policy intervention, and we would all be better off for it.

Fundamentally, as a matter of policy, it doesn't matter whether we devote \$X to innovation and commercialisation by appropriating tax dollars or by ear-marking \$X to superannuation savings. But the latter is likely to produce very much better *commercial* results.

2 Redundancies and spin-offs

As the inquiry is also looking for policy options that can help retain an innovation workforce, I would like to bring to the attention of the committee that the tax treatment of redundancies actually discourages innovation.

If a company decides that it needs to downsize and make redundant some workers, the company can claim a tax deduction for the redundancy payments. But if the company decides that it can't make a commercial success of some innovation even though some of the employees think that it can be done, and decides to spin those employees off in their own company with the same starting cash that would have gone into redundancy payments, then the company faces a tax liability. The company now has equity in a start-up whose valuation is not \$0.

Some variation of Peter Cooper's Stop the Geek Tax legislation might address some of these problems. We should **exempt shareholdings in start-up spin-offs from tax until there is meaningful value**.

3 Accruing R&D Expenses

There are probably opportunities for Australia's research organisations to provide value in \$5,000 chunks to Australian small businesses. I don't have any good examples of them, but accountants, management consultants, IT companies and marketers are all able provide valuable, world-class assistance to small businesses for these kinds of prices. So why can't research organisations?

I think it's because the minimum cut-off for R&D expenditure is \$20,000 per annum. If you only spend \$19,000 each year on research, you receive no government support.

As a result of this, research bodies tend not to have any contact with the 90% of Australian businesses with turnover less than \$2 million even though there may be value that can be provided there.

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It would be impractical and expensive to lower the threshold below \$20,000 because of the costs of policing and monitoring applications. But perhaps we could let small business **accrue R&D expenses** from one year to the next, and when they have spent at least \$20,000 they can claim it in that final year.

This would encourage micro-research projects, provide an additional source of funding and increase the knowledge base of Australian small business.

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This document is a submission to the Senate Economic References Committee's Inquiry on Australia's Innovation System.

It was written by Mr Gregory David Baker, as a private individual.