

Parliamentary Select Committee on Financial Technology and Regulatory Technology

KPMG responses to Questions on Notice taken on 5 March 2021

1. Digital asset regulation

Question:

“Thank you, KPMG, for your submission and your evidence this morning. In relation to digital asset regulation, what are KPMG’s views on how digital asset businesses—I’m thinking of cryptocurrency exchanges—and virtual asset service providers should be regulated in Australia? How can regulation in this space facilitate the development of these emerging technologies without exposing investors and consumers to unacceptable risks?”

Mr Pollari: That’s probably an area where we do not have our requisite expert in the room with us, so we might take that on notice.”

Response:

Virtual Asset Service Providers (VASP) are businesses and / or individuals that may provide several different activities and services. VASPs deal in ‘virtual assets’ – which hold digital value that can be digitally traded, or transferred, and can be used for payment or investment purposes. A common example of a virtual asset is a cryptocurrency, such as Bitcoin.

VASPs are continuing to disrupt and mature and are eyeing opportunities to scale up and institutionalize within the FinTech / RegTech landscape. Regulatory bodies are now taking the virtual asset industry seriously, while institutional investors are shifting from keeping a watchful eye, to actively engaging with the most professional players. In fact, some established financial services institutions are taking things a step further and are preparing their own virtual assets service offerings.

VASPs can in some ways provide increased security through strict customer onboarding and Know Your Customer (KYC) programs and build trust through advanced Anti-Money Laundering (AML) and Counter Terrorism Financing (CTF) practices. As such, in relation to regulation, legislative obligations and regulatory requirements should be technology-neutral and apply no matter what the technology is being used to provide a regulated service. Consumers should also be educated about the risks of investing in VASPs like the material on the government’s moneysmart consumer education website¹.

Licensing a virtual asset service provider or enabling them to be regulated under a provisional sandbox-style framework would further add to the industry maturity and strengthen investor confidence. Schemes in Hong Kong or Singapore could act as examples of learning and benefits of such regulatory framework that has led to a licence regime for digital asset exchanges and platforms². Both licensing initiatives attracted interest from global crypto platforms (bringing opportunities to these jurisdictions) and have provided further investor trust and user traction.

Looking ahead, VASPs that obtain regulatory licenses will likely be in a better position to comply with the stringent requirements of institutional investors and accelerate this new industry’s maturity.

¹ <https://moneysmart.gov.au/investment-warnings/cryptocurrencies-and-icos>

² <https://asia.nikkei.com/Opinion/Hong-Kong-should-not-take-cryptocurrency-finance-for-granted>

2. Australian Innovation Company Model

Question:

Mr Wardell-Johnson: I'm happy to send you further details, if you'd like, in relation to the idea, with some numbers that you can actually see. It's easier to see with numbers.

CHAIR: Yes, that would be good, if you could take that on notice.

Response:

Companies in 'start-up' mode can become starved of cash before an idea is properly developed. This often leads to good ideas moving offshore or simply being abandoned. Whilst there are several programs designed to encourage investment at this stage of development (e.g. early stage investor tax incentive, early stage venture capital limited partnerships, etc.), none have adequately solved the problem.

KPMG's 'Australian Innovation Company' proposal seeks to put cash into the innovation sector, by allowing the transfer, for full consideration, of a portion of tax losses arising from salary expenditure incurred by an 'innovation company'. The ability to do this would be linked to the subscription of equity. The proposal has the following advantages:

1. The concession follows a hard-nosed commercial decision to invest, rather than government seeking to pick winners;
2. The concession is likely to attract High Net Worth Individuals who are in a better position to both absorb the risk and to provide additional skills and guidance to the innovation company;
3. The concession is linked to salary expenditure paid to Australian resident taxpayers and thus provides a level of safeguard against leakage of revenue.

Key features are as follows:

1. The transferable tax loss is limited to a percentage (say 70%) of salary expenditure
2. The transferor and the transferee must be companies
3. Full consideration (non-assessable/non-deductible) is to be paid for the loss
4. An equity investment of a multiple of the loss (say 4 times) must be made for 2 years
5. An eligible start-up would need to be defined. It could be broad or narrow.
6. A maximum transferable loss could be set (say \$5m).

Example	
Tax loss attributable to salaries (top slice approach)	100,000
Transferable salary tax loss percentage	70%
Tax loss transferred	70,000
Company tax rate (say for simplicity)	30.0%
Value of tax loss transferred	21,000
Minimum Investment Multiple for tax loss transfer	4.0
Minimum investment	84,000
Minimum investment period	2 years
Years over which tax loss can be utilised by Investor	1 year
Average tax rate on \$100,000 salary cost	27.0%

Further worked example of the Australian Innovation Company proposal:

Current Environment - Investor or HNWI Co

Balance sheet at start of year

Assets - Cash	1,000,000	Equity	1,000,000
		Income at 10%	100,000
		Tax at 30%	(30,000)

Balance sheet at end of year

Assets - Cash	1,000,000	Equity	1,000,000
Assets - Cash from income	100,000	Additional profit	70,000
Tax Paid	(30,000)		
Total Assets	<u>1,070,000</u>	Total Equity	<u>1,070,000</u>

Australian Innovation Company

Balance sheet at start of year

Cash	100,000	Equity - Shldr A	50,000
		Equity - Shldr B	50,000
	<u>100,000</u>		<u>100,000</u>

Balance sheet at end of year

Cash	100,000	Equity - Shldr A	50,000
		Equity - Shldr B	50,000
Less cash on salaries	(100,000)	Loss from salaries	(100,000)
	<u>0</u>		<u>0</u>

Revenue Impact - Simplified and First Order

	Assessable & Deductible Amounts	Est. Revenue Benefit or Detriment	Unutilised Loss
Salaries (assessable on employees)	100,000	27,000	

Deduction for salaries (available to innovation company)	100,000		(30,000)
Investor or HNWI Co Income	100,000	30,000	
		<u>57,000</u>	<u>(30,000)</u>

With Tax Loss Transfer & Equity Investment at End of Year

Investor or HNWI Co

Balance sheet at start of year

Assets - Cash	1,000,000	Equity	1,000,000
		Income at 10%	100,000
		Tax at 30%	(30,000)

Balance sheet at end of year

Assets - Cash	895,000	Equity	1,000,000
Assets - Cash from income	100,000	Additional profit	70,000
Less Cash for Tax Paid Investment	(9,000) 84,000		
Total Assets	<u>1,070,000</u>	Total Equity	<u>1,070,000</u>

Australian Innovation Company

Balance sheet at start of year

Cash	100,000	Equity - Shldr A	50,000
		Equity - Shldr B	50,000
	<u>100,000</u>		<u>100,000</u>

Balance sheet at end of year

Cash - Original	100,000	Equity - Shldr A	50,000
Less cash on salaries	(100,000)	Equity - Shldr B	50,000
Plus cash from loss transfer	21,000	New HNWI Equity	84,000
Plus cash from new equity	84,000	Loss	(79,000)

	105,000		105,000
Revenue Impact - Simplified and First Order			
	Assessable Deductible Amounts	Est. Revenue Benefit or Detriment	Unutilised Loss
Salaries	100,000	27,000	
Deduction for salaries	100,000		(30,000)
Loss transferred Investor Co	70,000 100,000	9,000	21,000
		<u>36,000</u>	<u>(9,000)</u>
Reduction in Revenue Received		21,000	
Reduction in value of unutilised tax losses in the tax system			(21,000)

3. International best practice and software specific R&D schemes

Question:

“Ms Kipper: But it's really also about maybe catching additional things and really focusing on what is likely to give effect to what we're trying to do, or what the government are trying to do, in terms of encouraging innovation.

CHAIR: We would be extremely grateful for anything you can supply us, on notice, about international practice in this space which you think is clearer and better.”

Response:

Many countries offer a range of tax incentives for innovation which typically includes R&D tax incentives (offered by around 49 countries)³ which generally includes software development, to IP box regimes (termed ‘patent boxes’ - see response to question 4). For many countries, claiming software development under the relevant R&D tax incentive is not as contentious as in Australia. However, it is also recognised that a great deal of otherwise innovative software development does not qualify under any R&D tax incentive program as the innovation lies in the end product or service, not the software needed to deliver it. Thus it is not only the cutting edge cases of software development under the R&D tax incentive that need to be addressed, but also whether other innovative software should be supported through a tax incentive.

KPMG is aware of some limited, and narrow, examples of software sector specific tax incentives that exist outside Australia, however they are not readily applicable here due to differing taxation systems and policies. For instance, France, China and the US offer limited tax credits for some types of software development⁴.

As noted above, other countries offer other types of incentives that may not be specific to software, but nonetheless help offset the cost of innovative software development (either through reducing the cost of development or encouraging greater investment). In Australia at present, the major tax incentive on offer is the R&D tax incentive which has limited application when it comes to supporting software development.

Options for policy makers in Australia to better support innovative software development include:

- 1) **Better use of binding determinations:** The Board of Industry Innovation and Science Australia now has the power to make binding determinations which may be used to provide greater clarity to industry on what it considers qualifies as software-based R&D. This power may be used to provide clarity on the edge cases, but will not allow the Board to extend the definition to innovative software development that would not otherwise qualify as R&D; and/or;
- 2) **Expand the definition of qualifying expenditures:** the UK Government’s recent Kalifa Review of UK Fintech⁵ found that financial services firms were not always eligible for R&D tax credits due to their expenditures not qualifying as R&D. For example, unlike in the US, UK

³ See latest OECD data from December 2020 - <https://stats.oecd.org/Index.aspx?DataSetCode=RDTAX%20#>

⁴ The State of Louisiana in the US offers 25% credit on payroll and 18% credit on production costs. <https://www.opportunitylouisiana.com/business-incentives/digital-interactive-media-and-software-program>

⁵UK Fintech Review: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/971370/KalifaReviewofUKFintech.pdf

banks' technology spend related to innovation does not always qualify for significant R&D tax credits in the UK. Expansion is already being considered under the UK Government's call for evidence on the scope of qualifying expenditures for R&D Tax Credits. Australia could consider a similar review of qualifying expenditures to ensure activities like dataset creation are included.

- 3) **Software specific incentive:** Consider a specific software development tax incentive that allows companies to claim a tax incentive where the intended end product or service is innovative. This may leverage concepts such as the innovation principles as set out in section 360-40(1)(e) of ITAA 1997.

4. Patent box systems and international examples

Question:

“Of those OECD countries, of our main competitors for marginal investment into fintech, how many have a patent box system?”

Response:

Globally there are about 25 concessionary tax regimes for Intellectual Property, usually referred to as Patent Boxes or Innovation Boxes. Prior to 2016 these regimes did not require that the R&D performed, and thus the Intellectual Property created, was undertaken in the country with the Patent Box. Under certain agreements on Base Erosion and Profit Shifting initiatives, countries have agreed that in order to offer concessionary tax treatment for the Patent Box a significant portion of the R&D needed to be performed within that country. As such, it is notable that most patent box regimes now require the development work that gave rise to the patent (IP) to have taken place predominately in the country in which the tax incentive is sought. This requirement was introduced under BEPS Action No.5 and prevents organisations from taking advantage of a development tax incentive in one jurisdiction (e.g. R&D tax incentive) before moving the resulting IP to another jurisdiction to take advantage of a revenue based tax incentive (such as a patent box regime).

Consequently, when companies are evaluating where to locate R&D, they will now consider both R&D tax concessions and any concessionary tax treatment for the subsequent intellectual property located in a Patent Box. The below table sets out countries that have a Patent Box or similar regimes as at 2019, noting that some smaller jurisdictions have not been included. KPMG has referred to one source of ranking of a ‘Global FinTech Hub’, however this definition is subjective.

Table of Patent Box or Similar regimes (excluding minor countries) as at 2019

		Fintech Hub? **	IP Qualifying Assets	Tax Rate Under Regime	Tax rate that would otherwise apply
1	Belgium (BEL)	No	Patents, Software	4.44%	29.58%
2	China (CHN)	Yes (no. 23, 24)	Patents	15.00%	25.00%
3	United Kingdom (GBR)	Yes (no. 4)	Patents	10.00%	19.00%
4	Turkey (TUR)	No	Patents, Software, Category 3	0.00%	22.00%
5	Thailand (THA)	No	Patents, Software	3%, 5%, 8%	20.00%
6	Switzerland (Canton of Nidwalden) (CHE-NW)	Yes (no. 2, 3)	Patents	8.8% to 12.6% (effective)	14.50% (eff. 12.6%)
7	Spain (Navarra) (ESP-NA)	No	Patents, Software	8.40%	25.00%
8	Spain (Basque Country) (ESP-PV)	No	Patents, Software	7.80%	25.00%

9	Spain (ESP)	No	Patents, Software	10.00%	25.00%
10	Slovak Republic (SVK)	No	Patents, Software	10.50%	21.00%
11	Singapore (SGP)	Yes (no. 1)	Patents, Software	5.00% or 10.00%	17.00%
12	Portugal (PRT)	No	Patents	10.50%	21.00%
13	Netherlands (NLD)	Yes (no. 5)	Patents, Software, Category 3	7.00%	20.00%-25.00%
14	Luxembourg (LUX)	Yes (no. 19)	Patents, Software	4.988%	24.94%
15	Lithuania (LTU)	No	Patents, Software	5.00%	15.00%
16	Korea (KOR)	No	Patents, Category 3	5.00% to 12.50% Transfer; 7.50% to 18.75% Licence	10.00% to 25.00%
17	Italy (ITA)	Yes (no. 22)	Patents, Software	12.00% + 1.95% IRAP	24.00% + 3.90%IRAP
18	Israel (ISR)	Yes (no. 20)	Patents, Software, Category 3	5.00%/8.00%/7.50%/16.0 0%	23.00%
19	Ireland (IRL)	Yes (no. 17)	Patents, Category 3	6.25%	12.50%
20	India (IND)	Yes (no. 29)	Patents	10.30% to 11.85%	30.91% to 35.54%
21	Hungary (HUN)	No	Patents, Software	0.00% in case of capital gains of reported Qualifying IP and 4.50% in case of the benefits related to royalty income.	9.00%
22	France (FRA)	Yes (no. 18)	Patents, Category 3	10.00%	34.43%
23	Greece (GRC)	No	Patents	10.00%	28.00%
24	Malta (MLT)	No	Patents, Category 3	0.00%	35.00%
25	Poland (POL)	Yes (no. 25)	Patents, Software	5.00%	19.00%

**The Institute for Financial Services Zug (IFZ) of the Lucerne University of Applied Sciences has conducted [a comprehensive research study identifying the regions with the most robust FinTech ecosystems](#) using factors generally associated with driving entrepreneurship and innovation, as well as indicators related to financial technologies.

5. Further information on the UK's recently announced 'scale-up' visa scheme

Question:

“CHAIR: That's very good. We would be interested in how we could do that in Australia. I think we're very interested in how we can attract some of that talent from Hong Kong. We have a number of processes across government which are already looking into that, so please provide any further information if you have it.

Mr Pollari: Yes, we will, thank you.”

Response:

In March 2020 the UK Government invited Ron Kalifa OBE to lead a major independent review into the fintech sector. The review sought to identify what more industry and government could do to support growth and competitiveness and to ensure that the UK maintained its global leadership. The Kalifa Review highlights the opportunity to create highly skilled jobs across the UK, boost trade, and extend the UK's competitive edge over other leading fintech hubs including Australia. The report's recommendations included a recommendation to create a new visa Stream to enhance access to Global Talent for fintech scaleups.

Following the release of the Kalifa Review the [UK Government announced on 3 March 2021](#) that an elite points-based visa scheme will be established with a 'scaleup' stream, enabling those with a job offer from a recognised UK scale-up to qualify for a fast-track visa.

Under the new system, highly-skilled migrants, with a job offer from a recognised UK 'scale ups' — innovative high-growth fintech and cyber companies — will qualify for a fast-track visa, without the need for sponsorship or third-party endorsement. Scale-up businesses have an annual growth of at least 20% over three years, with at least 10 workers at the start.

The government will set out more details in July 2021, with the aim to launch the new visa scheme in March 2022.

This compares with Australia's Global Talent Scheme which has been refreshed and updated from its original November 2019 iteration. In particular, the Global Talent – Independent stream is designed to attract skilled migrants at the top of their field in identified sectors. This is in continued recognition that the competition for global talent is heating up. The Australian Government has responded to this in 17 December 2020 by revising the list of target sectors eligible for the program. As part of this revision, the increase from 7 to 10 target sectors increases the coverage of the program and ensures that Australia is investing in future-focused occupations and those sectors that will aid our economic recovery.

The expansion has meant the inclusion of additional industries such as Agri-food, Energy, Education, Infrastructure and Tourism and 'circular economy'. The Australian Government has continued to include financial services and fintech and the coined 'digitech' that presumably covers the old bundle target sectors of Quantum Information, Advanced Digital, Data Science and ICT. It is acknowledged that the broadening of the target industries is a large step in the right direction however there is currently no detailed information on which skill-sets fall into which categories. On its face, Infrastructure and Tourism may be an easy target area to determine a particular skill set's suitability. Conversely, determining whether an individual's skills fall under the 'circular economy' is not as easy. This can make the scheme difficult to navigate for those unsure of whether their skills meet a particular target sector and could act as a disincentive to use the program.

When focusing on the Global Business and Talent Attraction Taskforce and the messaging on the support for high-value businesses, it is noted that much of the focus is on the targeted funding and incentives available to business when operating in these industries, without offering similar

inducements for their employees on the visa side. The introduction of the Temporary Activity visa (subclass 408) Australia Government Endorsed Event visa under the Post COVID-19 Economic Recovery event only facilitates a temporary stay in Australia.

The Committee should consider recommending the introduction of clearer policies and guidelines on the identified target sectors to aide interest and uptake for highly skilled individuals and businesses. Greater permanent residence options for businesses and their employees contributing to Australia's economic recovery.

Lastly, improving processing times for the Global Talent Scheme and the business innovation and investment visa categories should be prioritised so that they are adaptable and responsive to market changes and business requirements would greatly improve take-up. The current processing times as indicated by the Department of Home Affairs under the GTI program is 90 days. This does not include the EOI timeframe and is much longer than other jurisdictions who promise fast-tracked processing under similar schemes (for example in Canada) of 2 weeks.

The processing times seen under some of the Business Innovation and Investment visa categories is extensive and unsustainable and acts as a significant disincentive to investors who want to start or acquire an interest in an Australian business. High-net worth individuals may consider investment in Australia 'too difficult' and opt to set up their businesses or invest their wealth in other jurisdictions.