AUSTRALIA'S BIOTECHNOLOGY ORGANISATION

AusBiotech submission to the Senate Economics Legislation Committee's Inquiry

into the

'Tax and Superannuation Laws Amendment

(2014 Measures No. 5) Bill 2014'

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Introduction

As the Australian representative body for the biotechnology industry, AusBiotech is pleased to make this submission to the Inquiry into the 'Tax and Superannuation Laws Amendment (2014 Measures No. 5) Bill 2014', based on comments from AusBiotech members and from its work to grow Australia's strength in biotechnology.

AusBiotech is a well-connected network of over 3,000 members in the life sciences industry, which includes bio-therapeutics, medical technology (devices and diagnostics), food technology industrial and agricultural biotechnology sectors. The industry consists of an estimated 900 biotechnology companies (400 therapeutics and diagnostics and 500 – 900 medical technology companies) and employs in excess of 45,000 Australians.

While the Bill (and therefore the Inquiry) is concerned with four amendments, AusBiotech writes only in regard to one: The plan to reduce the rates of the tax offset available under the research and development tax incentive by 1.5%.

The seemingly small, but not benign change, announced in the May 2014 Federal Budget, will permanently impact companies in tax loss. While the 1.5% reduction to R&D Tax Incentive is expected to be neutralised by the 1.5% reduction to the corporate tax rate (effective 1 July 2015), this expectation fails to take account of the impact on the many pre-revenue small companies that are in tax loss and therefore don't pay corporate tax.

While this cut and its flow-on impact may appear small or inconsequential, it will specifically disadvantage small pre-revenue and start-up companies, which runs completely counter to Government rhetoric and indeed the policy intention of the R&D Tax Incentive. AusBiotech also contends that the constant threats and tweaks to the R&D Tax Incentive are unsettling for biotechnology developers and undermine business confidence at a time Australia can least afford to falter.

Industry support

In public policy terms, the 2011 introduction of the R&D Tax Incentive was a momentous and pivotal inflection point for Australian innovation. We as a biotechnology community can already look back and congratulate the architects of the incentive for their foresight. The Incentive is actively attracting companies from around the world to bring their R&D to Australia.

The R&D Tax Incentive was the result of many years of work, campaigning and planning that started as far back as its recommendation by Dr Terry Cutler in the Innovation Review (*Venturous Australia*) of 2008. The innovation industry worked with the Federal Government for almost three years after the Review recommended it, to see the R&D Tax Incentive delivered as a 'landmark reform'. Together we worked long and hard and the policy represents an important 'legacy' to the economy and to future generations.

The R&D Tax Incentive was very well received by the industry and its intact preservation remains the number one public policy issue within the industry. Since the R&D Tax Incentive's implementation the annual Biotech Industry Position Survey (2013 & 2014) has ranked the Incentive amongst the industry's most pressing public policy issues, with survey respondents repeatedly expressing their support of the program and concern that it might be reduced or withdrawn.

Australia can no longer see itself as simply a mine, a factory or a farm. Although they are very important parts of our economy, we need to diversify and support emerging future industries such as biotechnology, which will generate productivity, wealth, jobs for our young people as well as high-tech manufacturing and more.

Biotechnology has the capacity to address the big issues of our time, such as food security, alternative fuels, ageing populations, personalised gene-based medicines and diagnostics, climate change, access to clinical trials – and the Federal Government recognises the important role in supporting such innovation with the R&D Tax Incentive.

Companies in tax loss disadvantaged

The Government announced in the May Budget that the R&D Tax Incentive will be reduced by 1.5% and that this will be 'neutralised' by a 1.5% reduction to the corporate tax rate (effective 1 July 2015). The proposal fails to take account of the impact on the many pre-revenue small R&D focussed companies that will not benefit from corporate tax reduction as they are in tax loss. The change will therefore permanently impact companies for as long as they remain in tax loss. This class of company was a focus of the public policy change to encourage growth via innovation, hence, this is a potentially-damaging reduction, eroding the support available for R&D and reducing the national benefit.

This change appears to be an unintended consequence that will discriminate against small start-up biotechnology and other R&D-based companies. AusBiotech, therefore, argues for an adjustment for pre-revenue companies, which equals the benefits enjoyed by companies obtaining any future corporate tax reduction. This adjustment would be consistent with the policy intent and support of start-up innovation in Australia.

This group of early-stage companies, that typically has prolonged periods of tax loss and no revenues, was particularly disadvantaged by the May Budget. The loss of commercialisation support provided by the Innovation Investment Fund and Commercialisation Australia makes the R&D Tax Incentive cut even more harmful.

The Biotechnology Industry Position Survey 2014 survey group, shows that the majority of companies are small companies and will be disadvantaged by the 1.5% reduction. Responding to the survey, 35 biotech companies estimated their annual spend on R&D for 2014 collectively at $611.75 million. Of this group 29 (84 %) had turnover under $20 million, and would therefore be eligible for the refundable R&D Tax Incentive.

Uncertainty damages technology development

Pre-revenue companies in tax loss are reliant on investment (venture capital, issuing equity, etc.) and grants to complete their R&D programs and reach commercialisation. Biotechnology development is a long-term activity that requires large investment. It can take 10 – 15 years and up to $1.2 billion to bring one biopharmaceutical product for early research to market. The Tax

Incentive allow companies to progress much faster than they otherwise would, increases their probability of global success and reaching revenues (and paying tax) earlier.

Given the industry's need for the R&D Tax Incentive, the constant threats and tweaks to the program are unsettling for biotech businesses and undermine business and investor confidence at a time Australian biotechnology can least afford to falter.

The negative impact that uncertainty of funding support has on product development/innovation companies is destabilising and the Government's program changes cause one of the greatest costs, in practical terms. As well as making it more difficult to attract investment, uncertainty strikes companies in two ways: firstly companies are not sure whether the measures they have put in place, the deals they have struck and the investments made are going to receive the benefit(s) the Government previously pledged; and secondly, those that have not made commitments yet are sure to hesitate and wait for a more stable environment.

AusBiotech has had feedback from overseas investors that they intended to invest in Australian innovation but saw the regular changes to policy as a discouraging risk.

Developing biotechnology is an especially long-term proposition and the constant threat to much-needed support is working against the industry from fulfilling its potential. Australia has just the same potential to be a nation driven by innovation as the world leader (the US). We have a strong education system, stable government, good regulatory, IP and legal environment and a proven track record in innovation. However, we have unstable public policy supporting innovation and constantly changing programs. If we as a nation are serious about innovation, we must address the gaps and maintain stability to create the right environment for innovation to thrive.

<u>The $20 million threshold</u>

It is also noteworthy that the $20 million turnover threshold that is used as a proxy to differentiate a large company from a small company has been arbitrarily set. The Cutler Review proposed, and AusBiotech agrees, that a higher turnover threshold of $50 million is the target if Australia is serious about encouraging research and development.

There is also a misconception that a $20 million turnover is equivalent to a $20 million profit or that the company is at least wealthy. Breaching the $20 million threshold doesn't necessarily mean those companies are actually making a profit. There are a cohort of companies in the $20 - $50 million turnover bracket that represent the borderline where they fluctuate above and below the line and are often still in the mode of building an asset (and in tax loss). Also, the link to an overseas partner can cause small local companies to lose eligibility.

<u>Summary</u>

If the Government proceeds with the announced plan to reduce the rates of the tax offset available under the R&D Tax Incentive by 1.5%, AusBiotech requests an adjustment for pre-revenue companies that equals the benefits enjoyed by companies obtaining any future corporate tax reduction. This disadvantage for small companies is seemingly unintended but will discriminate against small start-up biotechnology companies and is inconsistent with the policy intent and support for start-up innovation in Australia. AusBiotech also contends that the constant threats and tweaks to the R&D Tax Incentive are unsettling for business and undermine business and investor confidence at a time Australia can least afford it.