AUSTRALIAN INVESTMENT COUNCIL

24 August 2020

Budget Policy Division
Department of The Treasury
Langton Crescent
PARKES ACT 2600

By upload to consultation website

Pre-Budget Submission

Dear Sir/Madam,

As the voice of private capital in Australia, the Australian Investment Council is pleased to present its submission to Treasury for the 2020-21 federal budget.

Private capital investment has played a central role in the growth and expansion of thousands of Australian businesses and represents a multi-billion-dollar contribution to the Australian economy. Our members are the standard-bearers of professional investment and include private equity (**PE**)**,** venture capital (**VC**) and private credit (**PC**) funds, alongside institutional investors such as superannuation and sovereign wealth funds, as well as leading financial, legal and operational advisers. Our members include both Australian domestic and offshore-based firms.

Private capital fund managers invest billions of dollars into Australian companies across every industry sector of the economy every year. Australian-based PE and VC assets under management reached $33 billion in 2019 with an additional $13 billion in equity capital available to be invested in the short-term.

The Australian Investment Council is supportive of policy initiatives and reforms that help ensure our economy is competitive, innovative and able to support Australia now and into the future. In particular, the Council encourages initiatives that help expand entrepreneurship, increase productivity and support investment – initiatives that drive the development of skills and talent, productive capacity and innovation through technology.

While Australia's private capital industry has grown strongly over recent years, the sector's ongoing ability to support Australian businesses cannot be taken for granted. Even though the industry has the necessary funding to support current portfolio companies, its ability to continue to expand the depth and breadth of new investments into Australian businesses over the coming years is likely to be challenged by institutional funding constraints domestically and globally. There are four main considerations that are relevant to any analysis of the likely trends in relation to domestic private capital investment in the period ahead.

1) History shows investment into innovation and research falls after a crisis, despite being a key economic driver;
2) Early evidence of 'capital rationing' and some risk aversion materialising;
3) Constraints on access to institutional investment from superannuation funds due to a heightened focus on maintaining liquid positions and uncertainty in relation to future valuations; and
4) COVID-19 restrictions hampering the ability of fund managers to connect with (potential) investee businesses and institutional investors. This is particularly acute for new funds that do not have established relationships.

At this time, it is vitally important that the private sector partners with the government to regain the capacity to support the innovation ecosystem, emerging entrepreneurs and their businesses. Scaling-up new, fast-growth businesses can bring significant employment and economic benefits that will flow to all sectors of the Australian economy. It is therefore critical that the current generation of entrepreneurs is supported and encouraged to drive innovation and contribute to the next wave of employment and economic growth. Without this support, Australia risks losing the next generation of new, internationally competitive Australian businesses to other markets around the world.

This submission outlines policy initiatives aimed at regaining investment momentum, creating jobs and stimulating economic growth. The priority initiatives broadly are:

1. Introduce a **new public and private sector co-investment fund** to support Australian entrepreneurs and Australian fast-growth businesses.
2. **Fill skills and talent gaps** and build a pipeline of skills that will **support Australia's future growth industries**.
3. Fast-track outstanding legislation, **implement previously recommended reforms** and remove inconsistencies to improve the competitiveness of **Australia's investment regime.**

The industry is conscious of the demands on government arising from the COVID-19 pandemic. While the fiscal stimulus measures put in place over recent months have played an important role in supporting the economy during this unprecedented and unexpected shock, the industry also recognises that the impact on the federal budget has been significant.

To this extent, many of the initiatives proposed in this submission have little, or no, impact on the federal budget. As an example, the proposed co-investment fund would potentially require an allocation of funding from the budget, which would amount to a capital account investment similar in nature to the existing Biomedical Translation Fund.

The Council looks forward to participating in any future discussion about the themes set out in this submission as part of the government's federal budget process. If you have any questions about specific points made in our submission, please do not hesitate to contact me or Brendon Harper, the Australian Investment Council's Head of Policy and Research, on 02 8243 7000.

Yours sincerely

Yasser El-Ansary
Chief Executive

Introduction

The impact of the COVID-19 pandemic on every corner of the Australian economy has clearly been significant. The comprehensive nature of the government's public health response has allowed Australia the opportunity to benefit from being part of the 'first-mover' group of nations emerging from the COVID-19 pandemic, while many other developed economies continue to endure ongoing widespread shutdowns and restrictions on business activities. Given the competitive position in which Australia finds itself, there is a unique opportunity to reimagine and reshape the national economy for the future and to support this by continuing to grow investment into innovation and technology as building blocks for a more dynamic and agile economy.

To effectively capitalise on Australia's comparative advantage, the recovery must be underpinned by a comprehensive plan by government to bring about meaningful economic reforms for long-term prosperity. Key policy recommendations to support these broader economic reforms are outlined in the Australian Investment Council's *Roadmap to Recovery* policy paper of June 2020, a copy of which is appended to this submission as *Attachment 1*. In our view, the three pillars of Australia's future economic prosperity must be:

1. maximising the penetration and utilisation of technology as an enabler of economy-wide productivity growth and job creation;
2. going 'narrow and deep' in developing industries where Australia is, or could be, a world leader; and
3. supporting Australia's entrepreneurs and fast-growth businesses to create Australia's next generation of world leading businesses.

The recommendations outlined in this submission focus on these pillars and opportunities to secure Australia's future prosperity.

State of the Industry

Australia's $33 billion private capital investment industry employs close to 200,000 domestic workers across the economy and is a critically important investment and efficiency driver for Australian industries and businesses. Fund managers invest capital from a wide variety of domestic and offshore institutional investors to support the growth of thousands of high-potential Australian businesses. In addition to providing equity capital, private capital fund managers provide those businesses with a mix of strategic support, mentoring and networking to help them unlock growth opportunities in domestic and international markets, which underpins the creation of new jobs across all sectors of the economy and boosts economic growth.

Private capital makes a significant contribution to the Australian economy and accounts for 2.6% of our nation's GDP.[1] As Australia begins the long-term economic rebound over the months and years ahead, private capital's investment contribution will accelerate as a result of the industry's focus on high-growth businesses that tend to outpace non-private capital backed businesses[2]. In fact, economic analysis confirms that one in nine new Australian jobs are created by private capital-backed Australian businesses, which reinforces the important job-creating role that private capital investment can play across all sectors of the economy.[3]

One of the key challenges confronting ongoing investment into high-growth innovative businesses is the uncertainty surrounding the future pipeline of funding flows into the private capital sector, with COVID-19 already impacting the outlook for new investment capital flowing to the sector from domestic and international sources. The anticipated contraction in the availability of that institutional investment is likely to lead to a slow-down in the potential for venture

[1] Deloitte Access Economics (2018) *Private equity: growth and innovation*, April.
[2] Wilhelmus, J. and Lee, W. (2019) *Private Equity IPOs – Generating Faster Job Growth and More Investment*, Milken Institute, September
[3] Deloitte Access Economics (2018) *Private equity: growth and innovation*, April.

capital to support early-stage, high-potential businesses across many sectors of the economy including technology, life sciences, agtech, and others.

To realise the economic gains from the scaling-up phase of early stage businesses, it is imperative that initiatives are put into place now to support the ongoing investment needed to sustain and grow our innovation ecosystem. Without support, private capital fund managers will be forced to ration their available capital and risk not being able to fund future investments into Australian businesses and entrepreneurs. This will result in Australian ideas and Australian companies either not being funded, or being forced to relocate overseas, which would hinder Australia's economic recovery and jobs creation.

Government policy can play an important role in ensuring there is a flow of capital that can be deployed for investment into businesses that will create future employment opportunities and economic growth.

The recommendations below provide practical policy solutions that will help grow the pool of capital available to support investment into Australian businesses and create employment opportunities for the future. The policy solutions cover three core areas designed to:

1. Introduce a new **public and private sector co-investment fund** to support Australian entrepreneurs and Australian fast-growth businesses.
2. **Fill skills and talent gaps** and build a pipeline of skills that will **support Australia's future growth industries.**
3. **Fast-track outstanding legislation**, implement previously recommended reforms and remove inconsistencies to **improve the competitiveness of Australia's investment regime**.

Summary of Recommendations

Recommendation 1: *Implement a national co-investment program*
The Council recommends the government establish a national co-investment program to support ongoing investment into early-stage Australian businesses and Australian entrepreneurs.

Recommendation 2: *Support regions and areas most in need*
The Council recommends government introduces incentives for investment into regions and areas most in need based on similar model to the United States' economic 'Opportunity Zones'.

Recommendation 3: *Attract the best and brightest talent*
The Council recommends government boosts the offshore marketing of the national Global Talent Scheme to encourage some of the world's best and brightest skilled talent to move to Australia, and at the same time, encourage skilled Australians with valuable offshore experience in leading technology and innovation ecosystems to return home.

Recommendation 4: *Extend visas for foreign students*
The Council recommends government extend visas for foreign students who graduate from Australian universities in disciplines where there are skills shortages, allowing them to stay and work in Australia to build a pipeline of talent for Australia's new, knowledge-based economy.

Recommendation 5: *Foster entrepreneurship and teach digital STEM skills*
The Council recommends government allocates funding to institutions that can develop and deliver courses for tertiary students aimed at fostering entrepreneurship and teaching digital STEM skills.

Recommendation 6: *Fast-track the establishment of 'STEM Schools'*
The Council recommends government embeds STEM skills into the Australian School curriculum from primary school years through to tertiary education and fast-tracks the establishment of 'STEM Schools' modelled on Sydney Science College in Epping to expand accessibility for all Australians.

Recommendation 7: *Fast-track the implementation of the new LP CIV regime*
The Council recommends steps be taken to fast-track the introduction of a new Limited Partnership CIV that aligns with international best practice with a target start date of 1 July 2021.

Recommendation 8: *Improve existing VCLP and ESVCLP vehicles*
The Council recommends the 16 technical and interpretative issues in the ESVCLP and VCLP regimes be adopted and implemented as a priority.

Recommendation 9: *Increase support for CVCs and innovation labs*
The Council recommends government increases support for CVCs and Innovation labs through the introduction of new programs to attract greater public-private investment into high growth Australian companies.

Recommendation 10: *Streamline the Accelerating Commercialisation program*
The Council recommends that guidance be provided to the administrators of the Accelerating Commercialisation program to allow venture-backed businesses to access funding where they are eligible.

Recommendation 11: *Pause the R&D Bill*
The Council recommends the R&D Bill is paused to give scope for renewed terms and to allow for a regime that is more supportive of early stage businesses, particularly in priority industries.

Recommendation 12: *Reduce tax uncertainties for private capital investment*
The Council recommends the Australian government, including the ATO, work with industry to reduce the uncertainties and inconsistencies in the tax treatment of private capital investment into Australian businesses.

1. Encourage equity co-investment into Australian businesses

The timing is appropriate now to establish a new co-investment fund that can support the expansion of the funding pipeline for Australia's innovation ecosystem.

Australian jobs and industries rely on a steady flow of foreign capital to support investment into growing businesses across all sectors of the economy. Australia's demand for capital continues to be greater than domestic supply and as a result, Australia is a net importer of capital. Private capital firms are an important vehicle for attracting both domestic and foreign capital into Australia and into Australian business.

Due to COVID-19 restrictions, fund managers have not been able to interact with (potential) investee businesses and institutional investors as they have previously. This has led to increased due diligence times and challenges in establishing new relationships. This challenge is particularly acute for new funds or fund managers wanting to establish new funds and who need to establish close relationships with their investors.

Without support, private capital fund managers will be forced to ration their available committed capital, with the result being a potential slow-down in future investments into Australian businesses and entrepreneurs. This will result in Australian ideas and Australian companies either not being funded to the extent necessary domestically or being forced to relocate offshore. At this time, it is vitally important that the private sector partners with the government to regain the capacity to assist the innovation ecosystem, emerging entrepreneurs and their businesses. Scaling-up new, fast-growth businesses can bring significant employment and economic benefits that will flow to all sectors of the Australian economy. It is therefore critical that the current generation of entrepreneurs is supported and encouraged to drive innovation and contribute to the next wave of employment and economic growth. Without this support, Australia risks losing the next generation of new, internationally competitive Australian businesses and becoming an innovation laggard.

Establish a new co-investment fund

A meaningful and proven way that the government can work with the private sector to boost investment for Australian entrepreneurs and Australian businesses over the medium-term is to utilise well proven co-investment funding programs. The timing is also appropriate now to establish a new co-investment fund that can support the expansion of the funding pipeline for Australia's innovation ecosystem.

The proposed co-investment fund would have very little, or no, impact on the federal budget. It would potentially require an allocation of funding from the budget, which would amount to a capital account investment which would essentially be budget neutral.

This program could be modelled on established structures using qualified fund managers. For example, the Biomedical Translation Fund (BTF) is a program structure that is well recognised within government as a leading private and public sector collaborative model and could form the basis for a new national co-investment fund. There are alterative models for such programs which could assess the merits of a structure that is based on a 'fund-of-funds' type approach, versus direct investment into underlying investee businesses. The private capital industry is open to canvassing the relative merits of each approach, which takes account of the priorities of the government in this area of policy.

Government co-investment to support early stage and high growth businesses is a well-tested policy response. Co-investment programs are heavily used in the UK, USA, Canada, New Zealand, Germany, France and many other countries across the globe. Domestically, various co-investment programs exist at the state level, complemented by targeted national programs. Examples of co-investment funds are included in *Attachment 2.*

Recommendation 1: *Implement a national co-investment program*
The Council recommends the government establish a national co-investment program to support ongoing investment into early-stage Australian businesses and Australian entrepreneurs.

Objective of a new co-investment program

The objective of a new co-investment program would be to support the functioning of the Australian VC investment market through the current dislocation and uncertainty arising from the COVID-19 pandemic. This would allow VC funds to continue to provide funding and support to highly innovative Australian businesses and entrepreneurs in the early-stage and start-up phases.

The building momentum of Australia's private capital industry – of which VC is one component – growing to $33 billion in assets under management in 2019,[4] is testament to its role within the Australian economy. The industry's contribution to the domestic economy through employment and GDP illustrates the important role it can play in helping drive our economic recovery and creating meaningful, high paid jobs for Australians. Analysis by Deloitte Access Economics has shown that one in nine new Australian jobs are created by private capital-backed Australian businesses.[5]

While the private capital industry has committed funds available to support short-term investment over the next one to two years, the COVID-19 pandemic has created uncertainty in respect of access to funds over the medium-term (as discussed above). Without government support, there is a risk of losing a generation of highly innovative Australian businesses to other markets.

The co-investment program would be distinctively different to the government's previously announced Australian Business Growth Fund (**ABGF**) initiative, which is currently before the Senate. The genesis of the policy drivers for the ABGF was to respond to a defined market failure in respect of established small and medium-sized businesses having access to debt financing, and the need to often provide the family home as collateral. This was articulated in the fund's explanatory memorandum, where business owners "found it difficult to borrow more than around $100,000 on an unsecured basis to support their day-to-day trading activities. In addition, medium-sized businesses reported that it was hard to obtain additional finance once they have pledged all of their real estate as collateral."[6] The focus of the ABGF, once formally established, is to support minority investments into established SME market businesses, which is a distinctly different segment of the business sector than that which would typically attract VC investment. VC investment is typically directed towards early-stage businesses that have significant elements of innovation and novel product/service development, who have the opportunity to exponentially grow and expand their business through a domestic and international scaling-up strategy.

Supporting national areas of most need

The government could provide additional support to specific areas of the economy to support new ventures and innovative businesses in industries where Australia has a comparative advantage or in areas most in need. This is particularly true for some businesses located in regional and rural areas of Australia, despite the fact that regional Australia contributes one third of national output and is home to 8.8 million people.

Recent successful initiatives to tackle the issue of regional under-development include the establishment of the BTF and overseas schemes, such as the Opportunity Zones program in the US. These provide a blueprint for launching programs which couple government funding and private capital, directing it towards specific areas of need. The Australian Business Securitisation Fund is another positive example of encouraging higher levels of business lending into a specific sector, the SME market in this case, which otherwise would have been untapped. Such a pragmatic policy approach, coupled with strong industry consultation, could be effective in unlocking new sources of capital for investment into SMEs and high growth businesses more generally.

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[4] Preqin and Australian Investment Council, Yearbook 2020
[5] Deloitte Access Economics (2018) *Private equity: growth and innovation*, April.
[6] Australian Business Growth Fund Bill 2019 Exposure Draft Explanatory Materials, p3

Recommendation 2: *Support regions and areas most in need*
The Council recommends government introduces incentives for investment into regions and areas most in need based on similar model to the United States' economic 'Opportunity Zones'.

2. Skills and Talent

To be internationally competitive, Australian businesses need access to the world's best talent. Where local companies cannot access the necessary talent, they can be forced to relocate overseas, taking with them jobs and revenue.

Skills and talent are the lifeblood of growing and innovative businesses. Australia has a golden opportunity to be a destination of choice for high calibre talent through its attractive lifestyle, stable political system and future growth opportunities. The government's recent announcement in relation to tertiary education reforms is a positive step towards generating the skills required in the future. It is also important that the businesses and industries that will generate the jobs of tomorrow, including future graduates, are grown and supported now.

As the pipeline of talent is grown within Australia, there are currently skills and talent gaps within the private capital sector which need to be filled as a priority, particularly in C-suite roles and where technical or specialist experience is required - for example, senior engineers, senior medical researchers and product managers. While Australia builds its local talent base, it has an opportunity to attract the world's best talent. This is particularly true with a number of developed countries implementing restrictive migration regimes and continuing to struggle to contain the COVID-19 pandemic. To this extent, the current environment may be conducive to attracting the Australian diaspora who may have developed specialist skills overseas to return home.

Recommendation 3: *Attract the best and brightest talent*
The Council recommends government boosts the offshore marketing of the national Global Talent Scheme to encourage some of the world's best and brightest skilled talent to move to Australia, and at the same time, encourage skilled Australians with valuable offshore experience in leading technology and innovation ecosystems to return home.

Build the next generation of local talent

To compete against the world's best, Australia needs to attract and retain the world's best talent. This is particularly true for Australia as a net importer of capital and highly skilled talent. Education reforms, particularly in STEM disciplines, will help build the next generation of local talent, but in the short-term, immigration reforms will help facilitate the entry of much needed specialist skills not available locally.

Skilled migration has been a key feature of Australia's migration system, playing an important role in generating economic growth for successive decades. Australia has had a long history of supportive policies to attract business entrepreneurs. However, the rising global mobility of workers and heightened competition for talent means that it is important for Australia to have policy settings that are effective in attracting a critical mass of "new economy" skilled workers. These entrepreneurs will help generate new and sustainable business opportunities within the Australian economy into the future and every effort must be taken to attract and retain that talent.

The global search for talent is compounded by ever-more-rapid changes brought about by technology and innovation. Australia has to stay competitive to attract and retain the best and brightest.

The Council is supportive of the government's Global Talent – Sponsored and Independent Programs. While it is still early days in the lifecycle of these policies, the Council believes that they represent a step in the right direction for Australia's future capability around skills development. Further refinement of skilled migration occupation lists will play an important supporting role in identifying those specific niche skills that Australia should prioritise in order to build future growth.

Australia has a strong record of attracting foreign students to tertiary education. Many of these students arrive on visas that are valid for the duration of their studies, and then return to their home countries to develop their careers once their education here is completed. This pipeline of talent represents a potential source of the skills needed to address labour shortages in the short to medium-term.

Recommendation 4: *Extend visas for foreign students*
The Council recommends government extends visas for foreign students who graduate from Australian universities in disciplines where there are skills shortages, allowing them to stay and work in Australia to build a pipeline for a new, knowledge-based economy.

As outlined in the *Australia 2030 Prosperity Through Innovation* report released by Innovation and Science Australia, growth in jobs and occupations requiring STEM skills are outstripping overall employment growth across the economy. While skilled migration will help to address skills shortages in the near future, building a workforce from within Australia with relevant STEM skills will contribute to employment and future economic growth.

Recommendation 5: *Foster entrepreneurship and teach digital STEM skills*
The Council recommends government allocates funding to institutions that can develop and deliver courses for tertiary students aimed at fostering entrepreneurship and teaching digital STEM skills.

In the longer-term, building a pipeline of future employees with STEM skills from the Australian school system would help to increase the job prospects for Australians in the future.

Recommendation 6: *Fast-track the establishment of 'STEM Schools'*
The Council recommends government embeds STEM skills into the Australian School curriculum from primary school years through to tertiary education and fast-tracks the establishment of 'STEM Schools' modelled on Sydney Science College in Epping to expand accessibility for all Australians.

3. Fast track outstanding legislation and remove inconsistencies to make Australia more competitive

Differences to international practices or unexpected policy changes make Australia a less attractive investment location for offshore investors.

As a mid-level player on the global scene Australia remains an attractive, but optional, investment location for many offshore institutional investors. Differences to international practices or unexpected policy changes typically make Australia a less attractive investment location in the eyes of those offshore institutional investors. Unfortunately, Australia's legal and tax framework for private capital investment is inconsistent with international best practice in a number of areas. It currently necessitates duplicate and complex structures and deters higher levels of foreign investment.

The recommendations below provide practical policy solutions to increase Australia's attractiveness internationally. These changes, if implemented, would assist Australian businesses now and in the future to source the funds they need to grow and prosper.

Collective Investment Vehicles

One area where Australia's approach is inconsistent with international practice is its existing framework for collective investment vehicles (**CIVs**). These vehicles play a vitally important role in aggregating international capital for investment into Australian businesses.

Private capital funds make a material contribution to the Australian economy and Australian unlisted business investments. Approximately 64% of commitments to Australian PE funds[7] typically come from offshore investors, all of which flow through some form of CIV based in Australia. The importance of a world-class competitive CIV regime is an essential ingredient in building and expanding the pool of capital that can be attracted into Australian businesses. A number of large international investors have identified that the current structure of Australian CIVs is a material deterrent for investing more into Australia. As a result, these international investors are making decisions to invest in jurisdictions that have CIV regimes they are more familiar with. This often means Australia misses out on significant volumes of capital due to a policy infrastructure that is not as competitive and consistent with global practices as it should be.

These differences continue to exist despite the government's announcement in the 2016 federal budget – consistent with the recommendations of the 2009 Johnson Review into *Australia as a Financial Centre* – that it would introduce two new CIVs to grow Australia's capacity to attract inbound investment into our economy. These two CIVs, known as a corporate CIV and a limited partnership CIV, are yet to be implemented. The Council understands that work on the Limited Partnership CIV is yet to commence and is being held-up by delays in developing the corporate CIV.

Recommendation 7: *Fast-track the implementation of the new LP CIV regime*
The Council recommends steps be taken to fast-track the introduction of a new Limited Partnership CIV that aligns with international best practice with a target start date of 1 July 2021.

Venture Capital Limited Partnerships

In a move supporting investment into Australian businesses, the government implemented changes to early stage venture capital limited partnerships (**ESVCLPs**) and venture capital limited partnerships (**VCLPs**) on 1 July 2016. These changes were broadly supported by Australia's private capital investment sector. However, due to the speed with which they were introduced, there are a number of areas where technical and interpretative amendments and clarifications regarding these investment vehicles are necessary.

There is a range of uncertainties and inefficiencies regarding the current VCLP and ESVCLP regimes. An example of some of the uncertainties with the current regime include the tax treatment of investments whose value increases to exceed $250 million. It remains unclear if these investments remain exempt from 'excess' gains, under sections 51-54 and 118-408 of the Income Tax Assessment Act 1997 (Cth) or, if such an investment is sold out of a ESVCLP, as it may no longer be 'early stage' due to the company expanding and maturing, if such a transfer triggers a crystallisation event and (through application of Part IVA, the general anti-avoidance rule) a tax liability.

ESVCLP and VCLP investment vehicles play a critically important role in supporting high-growth Australian business via access to venture capital and growth capital investment. Because Australia does not yet have an internationally competitive Limited Partnership collective investment vehicle, the ESVCLP and VCLP regimes provide valuable mechanisms to assist in attracting investment capital into the innovation ecosystem.

[7] For FY2013-2017.

The ability of early stage companies to attract capital is hampered by certain design elements of the ESCVLP and VCLP programs. These include unnecessary differences to international practice and uncertainties in applying the program. A package of reform measures in this area has previously been presented to the government during the 2017 National Innovation and Science Agenda work (and since), but as yet a number of technical amendments are yet to be implemented.

Providing clarity and certainty on the framework for VCLPs and ESVCLPs and making them competitive with other jurisdictions will be attractive to early-stage investors considering medium and long-term investments into Australian businesses across a range of new and emerging sectors of the economy.

There are 16 separate technical and interpretative issues around the current ESVCLP and VCLP regimes which need to be amended as a matter of priority.

Recommendation 8: *Improve existing VCLP and ESVCLP vehicles*
The Council recommends the 16 technical and interpretative issues in the ESVCLP and VCLP regimes be adopted and implemented as a priority.

Empowering Corporate Venture Capital arms and innovation labs

Australia has seen a substantial growth in the number of corporates with corporate venture capital (**CVC**) arms or innovation labs, marking the important role that large organisations can play in driving and nurturing Australia's innovation economy. Despite this growth, recent research by the University of Sydney has demonstrated there is more work to be done as Australian boards are failing to understand the importance of innovation.[8] The study found that 57% of surveyed board members agreed that 'innovation has never been or was only an occasional board agenda item' with only 3% having science or technology expertise. An alarming 57% did not know how much their organisations spent on R&D and innovation.

Start-ups and SMEs can greatly benefit from increased support and investment by government through partnerships, grants and procurement. Government equity co-investment through the introduction of new programs to attract greater public-private investment into high growth Australian companies would have a positive impact on productivity, jobs and economic growth.

Recommendation 9: *Increase support for CVCs and innovation labs*
The Council recommends government increases support for CVCs and Innovation labs through the introduction of new programs to attract greater public-private investment into high growth Australian companies.

Introduce changes to streamline the Accelerating Commercialisation program

The Accelerating Commercialisation (**AC**) program has the potential to play a significant role in driving fast-growth early-stage businesses to expand and deliver world-leading products and services domestically and internationally. However, under the current administration of the AC program, VC-backed businesses are generally not permitted to access additional funding using the 'matching capital' principle.

As there is no specific policy or regulation that supports this adopted practice, it is appropriate that the government provides guidance for the AC program's administrators which clearly enables VC-backed early-stage businesses access to funding support through this important program.

Recommendation 10: *Streamline the Accelerating Commercialisation program*
The Council recommends that guidance be provided to the administrators of the Accelerating Commercialisation program to allow venture-backed businesses to access funding where they are eligible.

[8] Garbuio, M (2019) *Driving Innovation: The Boardroom Gap, 2019 Innovation Study*, September

Pause the introduction of changes to the current Research & Development Tax Incentive

The Research and Development program (**R&D**) is a critically important policy support mechanism which drives large parts of Australia's innovation ecosystem. The proposed reforms to the R&D tax incentive (**RDTI**), including to introduce annual caps under the refundable component of the program, will create restrictions on investment into job-creating innovation at a time when the Australian economy requires it the most. Given the significant change in Australia's economic situation at this time from when the proposed changes were first announced (in 2018), the Council recommends government halts any implementation of changes in this area of policy immediately. The uncertainty in relation to this regime is having the effect of impeding much-needed investment momentum by companies at the front-line of research and development of new products and services.

Furthermore, there are aspects of Australia's RDTI that are considered to be problematic such as definitional issues which impact on access to the program in respect of certain forms of software development. Any support that the government can provide to the Australian Taxation Office to assist in providing clarity on the policy objectives of the current regime would be helpful for all technology businesses seeking to scale in Australia.

The public transparency measures, which are also proposed in the Bill will require the Commissioner of Taxation to publish information about R&D entities that have claimed notional deductions for R&D activities, including the amount claimed within two years following the end of the relevant financial year. These changes could have the effect of diminishing the appeal of the program, and result in a loss of commercial in confidence information that could impact on the competitiveness of early stage businesses who are often seeking to build scale in niche areas of the market.

Under the current regime, there have also been numerous examples of inconsistencies where claims that were initially accepted were later rejected by the Australian Taxation Office. This *about-turn* on eligibility has had a material effect on many early stage businesses, who have relied on their access to R&D Tax Incentive refundable offsets in order to fund ongoing cashflow investment into R&D activities.

Recommendation 11: *Pause the R&D Bill*
The Council recommends the R&D Bill is paused to give scope for renewed terms and to allow for a regime that is more supportive of early stage businesses, particularly in priority industries.

Consistency in tax treatment

Private capital managers invest with the expectation of holding and growing their investments for a number of years. As such, those managers consider the potential performance and risks of their investments over the medium to long-term. Uncertainties due to variations in the tax treatments of investments increase investment risk, making investing in Australia less attractive. Inconsistencies in tax treatment have occurred, and continue to occur, in a number of areas.

These include, but are not limited to:

1. the tax treatment of investments whose value increase to exceed $250 million (detailed above in the *Venture Capital Limited Partnerships* section);
2. The deemed 'grouping' of independent private capital-backed businesses as one corporate group for the purposes of testing under certain federal and state-based tax regimes, for example in respect of the criteria contained within the current JobKeeper Program. Unlike consolidated corporate groups owned by a common parent entity, independent investee businesses within private capital fund structures are unrelated with one another and cannot participate in any cross-guarantees or subsidies that might otherwise be available in a typical consolidated corporate group structure;
3. Definitional issues such as the narrow interpretation of 'experiments' in the R&D Tax Incentive Law which are inhibiting investment into new innovations, especially for early stage companies (outlined in the *Research and Development Tax Incentives* section); and
4. Requirements to publish R&D entitlement which have caused inconsistencies, where claims which were initially accepted, were later rejected by the Australian Taxation Office (**ATO**).

The Australian Investment Council is available to assist the government explore these instances of inconsistent tax treatment to find solutions that will drive increased investment into Australian businesses.

Recommendation 12: *Reduce tax uncertainties for private capital investment*
The Council recommends the Australian Government, including the ATO, work with industry to reduce the uncertainties and inconsistencies in the tax treatment of private capital investment into Australian businesses.