

**TAX CONCESSIONS FOR ADOPTION
OF
AUSTRALIAN INNOVATIONS**

**Submission to the Review
of the
National Innovation System**

**Prepared and Submitted
by
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April 2008

Declaration of Interests and Affiliations

John Gouteff is an Executive Director of Tieline Technology, a privately held company, located in Malaga, Western Australia. John is an Electronics Engineer and has over forty years of experience in his profession. His main area of expertise is in the broadcast area and to a lesser extent, in the radio communications area. John worked for the Australian Broadcasting Corporation for seventeen years before taking a part ownership of Tieline in 1994.

Tieline is an Information and Communications Technology company, specialising in the design, manufacture and marketing of electronic hardware and software products. The principle market of interest is in the Radio Broadcast area however, Tieline products are used in all areas of the electronic media. Tieline products are also used in courtrooms, and for surveillance.

Executive Summary

This Submission is directed at encouraging the early adoption of local innovations by Australian Government and private industry, through a new tax concession scheme.

In the first model of the proposed scheme, private industry is given a 125% tax break for investment in an Australian developed product or solution that qualifies for an "Accredited Innovation Product or Solution". There would be a fixed period, say 5 years, during which the accreditation is valid.

In the second model, a graduated scale is used with 175% deduction in the first year, followed by 150% in the second and 125% in the last three years.

For Government Departments and Organisations, the incentive could be in the form of a Budget Bonus of 25% on all Innovation Accredited expenditure. Similarly, my second model could also be adapted for Government.

My second model would help innovators to commercialise their ideas much quicker. It would encourage innovators to meet target dates for commercialising the innovation and it would also encourage potential customers to commit to the innovation sooner rather than later. Time to market is critical for the success of any new innovation.

Early adoption is particularly important for small business and individual innovators as it is in the early phase of marketing the innovation where commercial success is vital. Vital in terms of cash flow, vital in terms of commercial credibility and vital in terms of acceptance in the market.

A further advantage of my proposal is that it leads to higher productivity. It has been shown that service providers that adopt new and innovative solutions achieve higher growth and productivity. My proposal encourages early adopters to take the risk to adopt more innovative solutions.

Last but not least, Australian innovators suffer from a huge geographical disadvantage. We are far away from most potential markets and our local market is very small. It is critical that Australian innovators succeed at home before they can succeed on the global scene. Foreign innovators have the advantage of much bigger local markets, there by having huge leverage to penetrate the Australian and other global markets. Its no coincidence that there is culture in Australia that prefers buying the imported innovation ahead of the Australian one.

Need For Adoption Incentives

Generally, the focus on innovation always seems to be on the “push” side. By that I mean that all the incentive to innovate is in the creation side. The Commercial Ready Grants and the R&D Tax Concession are typical examples of this. In my view, this is a very unbalanced approach to innovation. To provide a proper balanced incentive scheme, there should be a pull to go with the push. To add the necessary balance to innovation incentives, we need to consider incentives for the application and adoption of innovative products and solutions as well.

It is always a problem when a new innovative product hits the market. No one wants to be the first to buy. It's considered “high risk”, with good reason. It is rare for first of versions to be entirely fault or bug free. Consequently, there is a period where the innovator and the customer need to work together to resolve all the problems. There needs to be some incentive for potential users to take the risk and suffer some of the debugging pain.

So many innovations fail due to the long slow process of gaining market recognition and success. As time goes on, the lack of sales erodes the funding available for an on-going marketing program which is essential for generating new sales. Consequently, the innovation gradually fades away and eventually dies.

By encouraging early adoption of innovative products and solutions, the chances of the innovation being successful are greatly increased. This is particularly important for small business and individuals, as it is in the early phase of marketing the innovation where commercial success is vital. Vital in terms of cash flow, vital in terms of commercial credibility and vital in terms of acceptance in the market.

Tieline Technology went through a similar experience when developing the first Audio POTS Codec in Australia. But for a lucky break in making a large sale to a local customer, what then developed into to a successful global product could have died in the making.

Government procurement policy can also influence local innovation both directly and indirectly. The financial benefits of having Government Procurement policy favouring local innovation are fairly obvious. What is not immediately appreciated is the devastating impact that Government can have indirectly by purchasing competing foreign imports. By so doing, the competing foreign enterprise gets the financial gain and the local and international recognition. By contrast, the local innovator ends up out of pocket due to the wasted investment in pursuing Government tenders and no commercial credibility. I can relate to this through personal experience.

Models For Incentives

In this submission, I propose two possible models for tax incentives for innovation. I am sure that there could be many other variations but I hope to illustrate the thrust of my plan with these two models.

In my first model, I propose that private industry be given a 125% tax break for investment in any Australian developed product or solution that qualifies for an "Accredited Innovation Product or Solution". There could be a fixed period, say 5 years, during which the accreditation is valid. The scheme could be loosely modelled around the existing R&D Tax Concession scheme.

My second model is based on a graduated tax concession scale with say 175% deduction in the first year, 150% in the second and 125% in the last three years.

For Government Departments and Organisations, the incentive could be in the form of a Budget Bonus on all accredited expenditure. In the first model, there would be a budget bonus to the value of 25% of the accredited expenditure. Similarly, for my second model, the bonus values would be 175% or 150% or 125%, depending on the timing of the purchase.

The way that the scheme would work is that when an enterprise purchases a product or solution that has "Innovative Product Accreditation", the enterprise simply presents proof of purchase of an Accredited Product to exercise the entitlement to claim a Tax Concession. The concession effectively reduces the cost of the product, thereby giving an incentive for the adoption of the innovation. It is basically the same as a "Cash Back" scheme which is used extensively in the USA for product promotion.

Accreditation For Innovations

Accreditation will be necessary to be able to determine eligibility for the Tax Concession. Only expenditure for the procurement of Accredited products would qualify for a tax concession.

Again, I propose two simple methods for innovators to gain Accreditation. In the first method, I propose that Accreditation could be automatic for all Commercial Ready Grant recipients. This is an existing scheme with well documented objectives and milestones. The projects have a degree of innovation and risk, factors that should be essential in qualifying for accreditation.

Not all applicants for Commercial Ready Grants are successful. This is not due to the proposed innovation being unworthy of a Grant, but more likely due to a lack of available funds in a competitive scheme. I suggest that all unsuccessful CR applicants be considered for the Accredited Innovation certification as well. They would be required to make commitments in the same way that CR beneficiaries are required to do.

Other innovators who are not applying for a Commercial Ready Grant, could simply apply for the Accreditation. The applicants would have a similar assessment to the CR scheme.

Tax Concession Timeframes

For expenditure to qualify for a Tax Concession, there needs to be proof that a purchase was made of an Accredited Product and within the eligible time frame.

To set the SOL and EOL times for an Accredited Product, there will need to be a Start of Life date and an End Of Life date for the product. These dates could be established at the time of the assessment for Accreditation. Setting the dates at that time would provide an incentive for the innovator to get the product to market quickly, there by maximizing the chances of success.

In many cases, unforeseen problems arise during the development of innovative products and this can cause considerable slippage in getting a product to market. To allow for this, a one year window could be provided for the SOL date to slip, provided that the slippage can be justified.

Organisations making Tax Concession claims will have to provide proof of purchase. This will involve the presentation of a Purchase Order and a proof of payment with dates that fall within the Accreditation Time Frames.

To reduce the risk of this scheme being abused, it should be a requirement that there should not be any relationship between the Accredited Innovator and the Tax Concession applicant.

Tax Concession Examples

In this section, I show some examples of how the Tax Concession would work, under the two models that I have proposed. In each case, the claimant is assumed to have expended \$100,000 on an Accredited Product is making a claim for a concession.

Example Using Model 1.

A \$100,000 expenditure would entitle the claimant to claim a deduction of \$125,000. That deduction would result in an extra tax concession of \$7,500 based on the company 30% tax rate.

Example Using Model 2 @ 175%.

A \$100,000 expenditure would entitle the claimant to claim a deduction of \$175,000. That deduction would result in an extra tax concession of \$22,500 based on the company 30% tax rate.

Example Using Model 2 @ 150%.

A \$100,000 expenditure would entitle the claimant to claim a deduction of \$150,000. That deduction would result in an extra tax concession of \$15,000 based on the company 30% tax rate.

From the examples shown above, it can be clearly seen that there is a huge advantage for early adaptors of new innovations under Model 2. This would provide the kind of incentive needed to stimulate rapid commercialisation of innovative products.

Government Revenue Implications

Clearly, this Innovation Tax Incentive scheme would impact on Government revenue. However its not all bad for the Government. Even though there is a loss in revenue through the tax concession, the Government does pick up on taxation of the resulting profits.

If a product is purchased through an import agency, the profit margin on the item is likely to be under 20% of the sale price. So a sale of a \$100,000 product would result in a profit of \$20,000, thereby giving a tax revenue of \$6,000.

However, if a product is purchased from a local innovator for \$100,000, the profit is likely to be around \$50,000. The tax revenue on that is \$15,000. While this does not cover the revenue loss through the tax concession in year 1 of Model 2, it makes up for the loss in the remaining years.

From the two scenarios shown above, it can be seen how the government can be a clear winner over the five years of the Innovation Tax Concession time frame. In addition to the revenue benefits shown above, there are additional benefits to the Australian economy through export sales. The tax revenue generated from export sales alone would provide a very good return on investment for the Government.

Conclusion

In this submission, I make a number of suggestions about how my scheme could work. I do not claim that these are the only way that the program could be implemented. I am sure that under careful research and planning, many other variations could be equally as good, if not better at providing the necessary results.

I personally prefer my second model, as it would help innovators to commercialise their ideas much quicker. It would encourage innovators to meet target dates for commercialising the innovation and it would also encourage potential customers to commit to the innovation sooner rather than later. Time to market is critical for the success of any new innovation.

A further advantage of the proposal is that it leads to higher productivity. It has been shown that service providers that adopt new and innovative solutions achieve higher growth and productivity. My proposal encourages early adopters to take the risk to adopt more innovative solutions.

Last but not least, Australian innovators suffer from a huge geographical disadvantage. We are far away from most potential markets and our local market is very small. It is critical that Australian innovators succeed at home before they can succeed on the global scene. Foreign innovators have the advantage of much bigger local markets, there by having huge leverage to penetrate the Australian and other global markets.

Its no coincidence that there is culture in Australia that prefers buying the imported innovation ahead of the Australian one. The Government is leading by example. Here is an opportunity for the Government to show that it can provide the right example for everyone to go Australian Made.