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— **Exclusive**

Airtasker hit by R&D incentive tax crackdown that threatens tech firms

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Leading Australian tech start-ups, including high-profile online jobs marketplace Airtasker, have been hit by shock demands to pay back millions of dollars in Research and Development incentives, leading to fears the emerging local software sector could tank without reform to the scheme.

Start-up founders, top investors and industry leaders spoken to by *The Australian Financial Review* said qualification measures for the crucial industry support measure, which financially rewards companies for

investing in developing new ideas, were now being applied in such a strict and inappropriate fashion by the Department of Industry, Innovation and Science, that it was all but impossible for software companies to qualify.

The issue is looming as a potentially disastrous problem for the development of a vibrant Australian software industry, which many view as a key employer of the future.



Digivizer CEO Emma Lo Russo and Airtasker co-founder Tim Fung have both been slugged with unexpected demands to repay millions of dollars in previously awarded R&D incentives. **Janie Barrett**

It dates back to an [Australian Taxation Office alert from February 2017](#), which said it planned to review R&D claims from software companies amid concerns that advisory firms were encouraging companies to claim for work, which didn't count as pure R&D.

The government then [announced changes to the R&D tax incentive in the May budget](#) designed to save \$2.9 billion over 2018-19 to 2020-21 by

reducing grant levels for many claimants and beefing up compliance and enforcement measures.

Under [the changes](#) companies with turnover of \$20 million or less have R&D cash refunds capped at \$4 million, while their tax offset rate changed from 43.5¢ out of every dollar spent on R&D to a calculation of their annual corporate tax rate, plus 13.5 per cent.

However, crucially, AusIndustry has been cracking down on previously awarded incentives, applying a rigid framework known as the Frascati Manual to audit the self-assessed applications.

Paying back millions

The audits have led to numerous software-based companies being ordered to repay rebates worth hundreds of thousands of dollars each, with Seven West Media-backed Airtasker and social media analytics software firm Digivizer saying they are now faced with being millions of dollars out of pocket.

A number of other well-known technology start-ups also confirmed major fears about the application of R&D rules, but asked not to be named by *The Australian Financial Review*, for fear of attracting audits they would now be unlikely to pass.



Co-founder of Airtree Ventures Daniel Petre says it is vital for the future prosperity of Australia that the government quickly addresses the fact its most important scheme for supporting start-ups is not suited for software companies. **Peter Braig**

The R&D incentives are the most important government program for emerging technology start-up companies in Australia; under the ATO definition, companies must prove that they were working on experiments for the purpose of "generating new knowledge". These must be seeking to determine results that could not have been already worked out, and be conducted in certain prescribed ways.

Airtasker co-founder and chief executive Tim Fung told the *Financial Review* his company's two most recent R&D rebates, dating back to 2014, had now been completely rejected under audit, and he faced paying back millions of dollars, plus a potential 75 per cent penalty for making erroneous claims.

At the time of applying for the rebates he had engaged a tier-one professional services firm at a cost of tens of thousands of dollars to ensure the claims were watertight, and he said Airtasker would have been unable to grow as it since has, without securing the funds.

Time-consuming audit

Since being targeted for audit, Mr Fung said, Airtasker had needed to devote a huge amount of time and resources to walking AusIndustry through the details of its work, including thousands of pages of documentation and many days for its chief engineer and financial controller explaining the importance of the relevant research.

StartupAus CEO Alex McCauley says the present political climate is less favourable towards software development than it was two years ago, when talk of a national innovation agenda and "ideas boom" was at an all-time high. **Daniel Munoz**

Its claims were subsequently rubbed out, with little explanation aside from a statement saying it didn't meet the requirements.

"Moving forward, our assumption is that we just don't participate in the R&D program at all. From our planning purposes we've literally physically deleted it out of our business model, just so that we can remain conservative about maintaining our financials," Mr Fung said.

"It completely shakes the tree for us. We're fortunate that we have grown fast enough in the last four years that the scale that we are now at means we are somewhat able to absorb the repayment, but certainly if you're a company growing at 25 per cent a year, you would definitely not be able to pay it back."

Late last year, [Airtasker raised \\$33 million in a funding round](#), which has equipped the start-up with enough money to tackle ambitious international expansion plans. It has grown rapidly from employing just 15 people at the time of its 2014 R&D claim, to now having 200 staff globally, with 110 in Australia.

Minister for Industry Science and Technology Karen Andrews says Australia's R&D Tax Incentive has one of the broadest definitions of eligibility that sets it above other jurisdictions. **Alex Ellinghausen**

Lack of logic and understanding

Mr Fung said it was commonly accepted from 2012 to 2016 that software companies were supposed to use the R&D scheme, with a succession of innovation ministers talking up the importance of the sector to the future of the Australian economy.

He said he, and his peers in the industry, were perplexed at the lack of logic and understanding now being applied in the audit process about

how software development works, and questioned how claims could be judged on the 2017 guidelines, which were not in place when the original applications were made.

Airtasker's failed R&D claims involved working out how to combine two previously separate software languages, which it had demonstrated via web searches had not been done elsewhere before. It also developed machine learning and artificial intelligence algorithms to apply to online content moderation and detect undesirable behaviour on its platforms.

However, he said, the Frascati model required documentation that was more akin to scientific laboratory experiments, rather than agile software development methods, which are common across the tech sector.

James Spenceley, founder of Vocus, chairman of Airtasker and a start-up investor, says he has never seen such "black and white" behaviour before. **Fairfax Media**

Leaving Australia?

"I would definitely say this changes the landscape for incentivising start-ups to stay in Australia. From our perspective this puts us well below where we think Australia should be in terms of investing into and

encouraging the development of new technology and the technology industry," Mr Fung said.

"It will definitely change that position for us as to whether we make a decision to stay in Australia, or move elsewhere ... We hire software engineers in Australia and are creating jobs in that regard, but certainly if the incentives exist elsewhere to do that more economically, we have to think about that."

Approached about the concerns of the local software sector, Minister for Industry Science and Technology Karen Andrews said the government was listening to the needs of start-ups, and recognised the importance of these businesses to the economy.

Despite the ATO guidance and tough audits being conducted on software companies, Ms Andrews said the legislative definitions remained unchanged. She said AusIndustry's treatment of software was consistent with other countries with similar R&D tax incentives, including Britain and Canada.

Additional assistance

In addition to R&D incentives, the Minister said, the Coalition had put new tax incentives for early stage investors and early stage venture capital limited partnerships in place, to encourage more investment in young, innovative companies.

"Australia's R&D Tax Incentive also has one of the broadest definitions of eligibility and sets us above other jurisdictions," Ms Andrews said.

"Being a self-assessment program, even if they engage a consultant, companies are ultimately responsible for their own claims and need to ensure the advice they receive is of a high quality ... Previous guidance released by AusIndustry and the ATO has raised awareness of the identified risks and alerted the tax profession to the need to correctly claim the R&D tax incentive.

"Companies are provided with documents that describe any compliance concerns, so that they are able to address these issues."

Despite this chief executive and founder of Digivizer Emma Lo Russo said her company also faces repaying more than \$1 million in rebates after AusIndustry deemed its research "does not constitute new knowledge".

Ms Lo Russo, who spent \$80,000 on professional advice to help ensure Digivizer's claims complied with the R&D rules, said the finding was both baffling and "very, very frustrating".

Trying to do the right thing

She said Digivizer's analytics software for businesses and content creators, was a direct result of her team's research and development efforts.

"It's access to the R&D rebate that has allowed us to create something new, which is what you need to be competitive and attractive," she said.

"I want to be doing the right thing. I want to be a poster Australian technology brand that people look to and see and feel the pride that they feel around those that have already been successful."

CEO of start-up advocacy group StartupAus Alex McCauley said the present political climate was looking upon software development less favourably than it did two years ago when [talk of a national innovation agenda and "ideas boom" was at an all-time high](#).

After the 2016 federal election saw a fall in support for the government, many in the Coalition perceived that voters were worried about the impact on jobs from new technology, and dialled back support for the sector.

Government shifts focus

"There is no way these claims would be dismissed in 2015, but looking at them in 2018 and the way the government is thinking about software now, they're being looked at differently," Mr McCauley said.

Co-founder of Airtree Ventures, [one of the country's biggest tech-focused venture capital funds](#), Daniel Petre, said it was vital for the future prosperity of Australia that the government quickly addressed the fact that its most important scheme for supporting start-ups was not suited for software companies.

Mr Petre is also a board member of Innovation and Science Australia, an independent statutory board set up in the Department of Industry, Innovation and Science to advise government on innovation, research and science matters.

"Whether we like it or not, the future is a world where everything is underpinned by software and one where all the growth in employment will come from tech-focused firms, many of them scaled start-ups," Mr Petre said.

"Job growth is not coming from the banks adding more people, big end mining adding more jobs, retail adding lots more jobs. It is all about tech, healthcare and maybe education.

"The government pulled \$2.4 billion out of R&D last year and now you are seeing software companies getting audited and told to pay all the money back ... They don't have the cash and will go out of business, it is a clusterf---. Everyone in the start-up industry, which is creating thousands of jobs, has no idea how to engage in a sane conversation with government and so has no idea what to do."

New definition

Mr Petre said R&D incentives were the difference between small software companies having the chance to grow or dying. He said routing of the system was more likely at large institutions with armies of accountants than at emerging start-ups, and that new definitions of R&D – relevant to tech start-ups – were urgently required.

He said access to the funding meant start-ups could grow bigger before seeking external VC funding, which in turn meant founders were less diluted, made more money when they exited and would then pour more money back into the local ecosystem in future.

"Software is developed in agile teams, which try things and discard things, it doesn't map well to the structure that the Frascati model tries to create," Mr Petre said.

"They really need a new definition for what counts as R&D in software, but we are all going to be dead by the time the government decides on one."

Shadow Minister for the Digital Economy Ed Husic said he had raised concerns with previous Minister Kelly O'Dwyer about concerns that software companies would simply stop applying for R&D incentives, out of fear of failing future audits.

"While it's crucial that all firms use the incentive according to the rules, we've been concerned for a while that a sledgehammer is being used to crack a walnut," he said.

A vendetta?

"We've got to get the balance right and we'll be seeking a briefing from the Minister about this particular matter."

James Spenceley is both a seasoned entrepreneur, having founded telecommunications company Vocus, and an increasingly prolific investor in Australian start-ups through his MHOR Asset Management business. He is chairman of Airtasker as well as owning the Illawarra Hawks National Basketball League team.

He said he disputes the idea there has been no change in approach from the government towards supporting technology start-ups, and is worried because he believes the R&D incentive scheme has been central to the developing strength of the local tech scene.

"Out of the blue, the government just came back and said we're not accepting any of your previous claims going back two years ... I've done 10

years of R&D claims, but I've never seen sort of black and white behaviour like this," Mr Spenceley said.

"I don't know if it's a vendetta, or they're trying to send a message."

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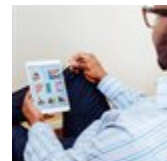
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