



Law Council
OF AUSTRALIA

Business Law Section

Manager
Individuals and Indirect Tax Division
The Treasury
Langton Crescent
Parkes ACT 2600
Via email: startuptaxincentive@treasury.gov.au

3 March 2016

Dear Sir or Madam,

Tax Incentives for Early Stage Investors

The Taxation Committee of the Business Law Section of the Law Council of Australia ("**Committee**") is grateful for the opportunity to make a submission to Treasury on the policy discussion paper in respect of the proposed tax incentives for early stage investors ("**Discussion Paper**").

The Committee supports the proposed tax incentives contemplated by the Discussion Paper, as it will aid Australian innovation companies in obtaining valuable funding and meaningful assistance from investors.

Subject to the comments and clarification sought below, the Committee agrees with the proposed tax incentives for early stage investors. The Committee hopes that a concise and pragmatic approach is taken in drafting the final legislation to ensure that the scheme is accessible and free from red tape.

Australian Innovation Company

The current definition of "innovation company" is too restrictive and will significantly limit the growth potential of companies that need working capital.

The proposed tax incentive should utilise a definition of "innovation company" that is as inclusive as possible. The principles based approach is the appropriate method to ensure that a diverse range of "innovation companies" are included. We would recommend two changes, being: (a) reconsidering the need for a list of exclusions, on the basis that a company will already need to be both innovative and eligible under the prescribed conditions; and (b) increasing the financial and time restrictions.

In this regard, we suggest that an innovation company have the same parameters as the definition of a start-up company as defined in section 83A-33 of the ITAA97 (i.e. there are no restrictions on the activities of a start-up entity to be eligible for the concessions and no

GPO Box 1989, Canberra
ACT 2601, DX 5719 Canberra
19 Torrens St Braddon ACT 2612

Telephone +61 2 6246 3788
Facsimile +61 2 6248 0639

Law Council of Australia Limited
ABN 85 005 260 622
www.lawcouncil.asn.au

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restrictions based on assessable income (noting the \$50m aggregate turnover) or expenditure).

If there is a determination process, it should be as simple as possible. The companies that will be seeking to obtain benefits from the proposed scheme will not be in a position to spend a lot of money trying to qualify for the concessions. On this basis, the narrower the definition and the more gateways and safe-harbours that companies must meet to qualify, the less beneficial it is for those companies.

Direct Investment into an Innovation Company

We do not think that the incentive should only be available to sophisticated investors. To qualify as a sophisticated investor, one must be an institutional investor or have a certificate from a qualified accountant that indicates that they have the requisite assets or income to qualify.

We suggest that all types of investors be able to benefit from this incentive, regardless of sophistication, assets or income. Restricting the types of investors will restrict the amount of capital invested into innovation companies. If the Government is worried that this may lead to non-sophisticated investors losing money, there could be an investment cap, for those investors, for example 10% (not 30%) of the issued capital of the innovation company.

Further, we anticipate that many investors will invest directly (not via a fund) in an eligible innovation company, through their own private company (which will not themselves be an innovation fund). We suggest that there is some mechanism for the benefit of the tax offset or the capital gains tax relief to flow through to the shareholders of such investment companies.

The Discussion Paper mentions that capital losses will be unavailable for share issues that are subject to the proposed incentives, and that in lieu of them, immediate tax offsets will be available. We assume that these are the tax offsets that are generally available under the scheme, however, after the shares have been held for 10 years and CGT becomes applicable, will the restriction on capital losses still apply? This will need to be clear in the legislation.

Indirect Investment via an Innovation Fund

The Discussion Paper is silent on whether each investor into an innovation fund will be separately entitled to claim the full amount of the tax offset or whether the maximum amount the fund can claim is a total of \$200,000 (whereby shareholders are entitled to part of the \$200,000 based on shareholdings). We assume that it is the former, but the legislation would need to be clear on this point.

The legislation should also indicate whether the CGT exemption will apply only to shares which the fund acquired after an investor invested in it, or whether it depends simply on how long the fund itself has held the shares. That is, does the fund get the CGT exemption and flow this to shareholders, or is it applied at the shareholder level. We suggest that the exemption is applied to all shares that the fund has held for the requisite period, in order to reduce the associated administrative burden.

Additionally, further clarification is needed in respect of whether a sale of shares in the fund itself would attract CGT. One issue here is whether a new owner of shares in an innovation fund can obtain the benefit of the CGT exemption if the fund has held the appropriate investment for the required period. We suggest that they should be able to obtain this benefit, as any tax free status of capital gains would be factored into the purchase price of the innovation fund shares.

In addition, we believe that all taxation measures should be applied at the fund level, as it would be far too great an administrative burden otherwise.

Integrity Measures

We suggest that transitional measures be introduced to apply from the date the National Innovation and Science Agenda was announced so that investment in start-ups does not slow down in anticipation of the Tax Incentive coming into effect.

The Discussion Paper does not provide much information around what happens if the \$200,000 cap is breached by a number of affiliates. The legislation should be clearer on the operation of the Proposed Incentive as between affiliates.

We agree that an innovation company should be an Australian resident to ensure that Australia's economy benefits from the proposed incentive.

Further submissions

Due to the time limits imposed for lodgement of submissions, the Committee's comments have been limited to those which were immediately apparent. The Committee would be happy to provide further comment if further time is made available.

If you have any questions in relation to the submission, in the first instance please contact the Committee Chair, Adrian Varrasso, on 03-8608 2483 or via email: adrian.varrasso@minterellison.com

Yours faithfully,

A handwritten signature in black ink, appearing to read 'Teresa Dyson', written in a cursive style.

Teresa Dyson, Chair
Business Law Section