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24 February 2016

To Sir / Madam

Re: Submission re consultation paper on tax incentives for early stage investors

We appreciate the opportunity to respond to your request for submissions on the tax incentives intended to provide concessional tax treatment for investors through a non-refundable tax offset and a capital gains tax (CGT) exemption on investments that meet certain eligibility criteria.

We do believe that there some early design item issues that need to be addressed before the policies are progressed to exposure draft legislation. However, given the short timeframe, we have not been able to address all of the questions contained in the policy discussion paper. We do attach some comments on the issues we thought of most importance in the attached annexure, and hope that these prove useful in your consideration of the draft legislation.

We look forward to contributing further comments once the exposure draft legislation has been released.

Should you wish to discuss our submission in greater detail, please do not hesitate to contact either me on (03) 9671 7592 or alternatively Roisin Arkwright on (02) 9322 7412.

Yours sincerely

Helen Fisher
Director
Deloitte Tax Services Pty Ltd

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Annexure

Australian innovation company

4.1 Are there any additional principles that should be included in defining an innovation company?

4.2 What gateway criteria would best define an eligible innovation company?

4.3 Do these criteria meet the objective of attracting investment in innovation companies, without unnecessary regulatory burdens?

4.4 What integrity risks are associated with each of these criteria? How might these risks be mitigated? For example, combining multiple tests together could mitigate risks.

We agree that the three methodologies set out in the paper are appropriate criteria in defining what an innovation company may be.

However despite the need to minimise risks, we would comment that it will be important when drafting the relevant provisions that these gateway criteria are largely drafted as alternative ‘or’ tests, rather than as cumulative ‘and’ tests.

This should also extend to the different configuration tests that are proposed to be within the safe harbour or gateway method – for example many companies may not apply to approved accelerator programmes.

4.5 Are investors open to a process that involves lodging a self-assessment declaration prior to making investments, in order to assist with assessing take-up and eligibility?

We believe so. On the issue of self-assessment we also believe that investors should be able to choose between whether they seek a specific determination from the ATO, or self-assess, as is the current practice with administering the tax law. As such, the majority of investors should be able to rely on a ‘pure’ self-assessment process.

4.6 In relation to a gateway requirement that is based on approved accelerator programs, which types of organisations should be included and what qualifying criteria should be specified?

As alluded to above, we believe that this is suitable as a standalone test but should not form part of each access test.

4.7 Are there any other investment activities should be excluded?

On the subject of exclusions, we believe that some of the listed exclusions are inappropriate. For example, the receipt of royalties or licence fees would preclude small entities who recoup some of their costs by licensing previously developed IP or parts of their IP from being eligible. We believe that such an exclusion should be removed or reworded.

Similarly, the farming or market gardening exclusion could unfairly preclude companies pursuing agricultural innovations who test their innovative products in situ on existing farms from eligibility.

4.8 Is it appropriate for innovation companies to be restricted to companies that are Australian residents for tax purposes?

We do believe that this is appropriate.

Direct investment into an innovation company

5.1 *Are there any specific requirements that should be included within the sophisticated investor test to ensure that innovation companies are benefiting from both financial and technical/commercial support?*

5.2 *Other than the sophisticated investor test contained in the Corporations Act 2001, are there alternative tests that can achieve these same objectives?*

We do not believe that a sophisticated investor test is necessary and in fact believe that the presence of such a test will preclude the eligibility of many investors that are currently a significant source of investment in start-ups, namely the family and contacts of the start-up founders.

We believe that this layer of complexity is unnecessary and the provisions should be open to anyone with available funds, as happens currently. The incentive should be a positive encouragement for investors rather than a deterrent.

Indirect investment via an innovation fund

6.2 *What is the most appropriate corporate structure for an innovation fund? What registration requirements should exist?*

We fail to understand why it is proposed that an innovation fund must be a company especially given that it will then be deemed to be a flow through vehicle for the purposes of these tax incentives. We believe that unit trusts and managed investment trusts, as well as VCLPs and early Stage VCLPs, would also be suitable structures to be an innovation fund.

6.3 *Should the incentive be limited to sophisticated investors in the case of investments through a qualifying innovation fund?*

No. See above – we believe there should be no sophisticated test for direct investments. If one is included for direct investments, it should certainly not be extended to indirect investments.

6.4 *Should qualifying innovation funds be proprietary limited companies, unlisted public companies, or some other company governed by the Corporations Act 2001?*

See comments at 6.2 above.

As an additional comment, the requirement that an investor may hold a maximum of 30% of the shares in a company does not interact well with the requirement that an innovation company must have expenditure of less than $1m in an income year. If a company attracts an investor to invest the full $1m investment which constitutes a 30% share of the company, the inherent value of the company is $3.3m.

In such circumstances, the interaction of the two caps together mean that a company cannot spend the capital it has raised or accelerate it, which will result in an inefficient use of capital; the very opposite result that the incentives is seeking to achieve. In addition, the 30% cap could potentially drive artificial valuations of start-up companies.