



Manager
Individuals and Indirect Tax Division
The Treasury
Langton Crescent
PARKES ACT 2600

By email: startuptaxincentive@treasury.gov.au

24 February 2016

Dear Sir / Madam

Tax Incentives for Early Stage Investors

We refer to your Policy Discussion Paper in relation to the proposed tax incentives for early stage investors.

PricewaterhouseCoopers (PwC) welcomes the opportunity to make a submission in relation to these important reforms.

1. Eligibility criteria: Innovation company

The discussion paper sets out a number of criteria that must be met in order to qualify as an innovation company.

3-year cap

In order to qualify as an 'eligible innovation company', the company must have been incorporated in Australia during the last three income years.

We consider that limiting the eligibility window to three years is prohibitive and does not contemplate a scenario where companies are registered, left dormant or as a "shell" company and then utilised at a future point in time. This could be the case for example where specific intellectual property is intentionally housed by an entrepreneur in different companies. The entrepreneur could incorporate a number of shell companies and only utilise a company when a new business idea/concept is explored.

There may also be a risk that the 3-year limit will not allow a company sufficient time to meet the ultimate definition of "a qualifying innovation company" at the time it has a need for additional capital to support its future innovative pursuits. The examples of principles-based innovation (i.e. the company needs to be the developer of new products/services, new platforms, new organisational/marketing method) may not yet be achieved by a company that is less than 3 years old. The company may still be in the process of research and development and therefore not yet able to demonstrate that it has an idea/product/service that other organisations or consumers could use.

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We therefore submit that the time limit be removed completely as this will reduce complexity.

Other criteria

We consider that the other eligibility criteria may also be prohibitive.

For example, if the company is raising (potentially) in excess of \$1 million, it may be common for the company to have spent over \$1 million in the preceding year developing an early stage concept, therefore making it unable to qualify as an eligible innovation company.

A more realistic cap for prior year spend may be \$2 million. Capital raisings in this area are typically around \$500,000. Therefore the \$1 million threshold would likely only facilitate two rounds of capital raisings which may not be enough to get a company to the commercialisation stage.

That said, a less prescriptive approach to eligibility may be more appropriate to ensure there are not unintended exclusions from the regime. This would be consistent with the Government's intention of having a "principles-based" approach to the design of the legislation.

International experience – principles based approach to innovation

China has considered the definition of 'innovative companies' and offer complementary Research and Development (R&D) programs to businesses which meet the following criteria:

- Products/services that fit into a key technology area,
- Percentage of personnel engaged in Scientific, Technical or R&D activities,
- Engage in qualified R&D activities and incur relevant R&D expenses,
- Intellectual property registration or licensing requirements, and
- Proportion of revenue generated from R&D products.

By removing the 3-year cap and by using some form of criteria (such as those noted above), it could be feasible to have a targeted program that enables all companies to access this incentive with some sort of limit in place (e.g. turnover, expenditure) to ensure the incentive will be largely accessed by seed and small and medium-sized enterprises who are in the most need of equity investment. The criteria outlined above could be made a requirement of the eligibility criteria in both instances – for example a seed/start-up as well as for a more mature company.

Impact on broader Research and Development reforms

We consider that the concept of an 'innovation company' should not be used for any other broader R&D reforms that may arise in the future without full and proper consideration having regard to the specific reform.

2. Treatment of capital gains

Under the proposed concessions, investors (including a qualifying innovation fund) will not pay any capital gains tax (CGT) on gains from the disposal of shares in an innovation company provided these shares are held for at least three years. Where shares are held for more than 10 years, any incremental gain in value after 10 years will be subject to CGT.



We consider that the introduction of a 10 year holding rule would effectively force the sale of many investments in order to obtain the capital gains tax exemption, even though commercially it may not be the right time to exit the investment. Early exits may mean that the stated policy objectives of these concessions (i.e. encouraging investment into Australian innovation companies) are not met.

Whilst acknowledging that investors will receive market value cost base in the shares at the end of the 10 year prior, this may be an insignificant amount particularly if the full potential of the innovative investment activity has not been realised.

This effectively creates an unfair playing field between managed funds and Australian family groups. A managed fund's portfolio is typically structured with an investment lifecycle of less than 10 years. However, in our experience, many Australian family groups' wish to retain their investments for a longer period, and may therefore be disadvantaged by the operation of the 10 year holding rule.

We submit that consideration should be given to removing the 10 year holding rule (and the initial 3 year qualifying period) and instead replacing it with a, say, '5 year exemption rule'. That is, once an investor has held an investment for 5 years, all future gains on sale would be exempt from capital gains tax. A '5-year exemption rule' would apply regardless of whether the investment is held directly or via an innovation fund.

Should you have any questions in relation to the submission please do not hesitate to contact the writer.

Yours faithfully

A handwritten signature in black ink, appearing to read 'Kel Fitzalan', is written over a light grey rectangular background.

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