

StartUpGiving

Move The Dial Limited (ABN 13 655 567 767), trading as StartUpGiving
Email: info@startupgiving.com.au
www.startupgiving.com.au

Director, Not-for-profit Unit
Individuals and Indirect Tax Division
The Treasury
Langton Crescent
Parkes ACT 2600

Sent via email: charitiesconsultation@treasury.gov.au

5 May 2022

Dear Director

Move The Dial Limited (ABN 13 655 567 767) trading as StartUpGiving (**StartUpGiving**) is pleased to make a submission on Treasury's consultation on the distribution guidelines for ancillary funds dated March 2022.

StartUpGiving has been founded by Daniel Petre and Antonia Ruffell to inspire a culture of giving in the innovation community. We have separately attached an article as **Appendix A** published in the Australian Financial Review on 27 April 2022 that further explains StartUpGiving.

StartUpGiving's mission is to encourage greater philanthropy in the short-term as opposed to just engaging potential donors who may make commitments that do not result in any material philanthropic donations for years or perhaps decades. Our focus in this submission is on founders or other equity holders (herein referred to as '**donors**') of tech startup companies who are still building their companies and have yet to realise any significant financial returns. Their main asset is a portfolio of shares in their 'startup' which is unlisted and private.

We want to help founders and executives to pursue philanthropy by donating principally shares in their companies to private ancillary funds (**PAF**). Motivating donors to donate shares to PAFs will enable them to have a materially greater impact on the charitable sector as they are:

- Contributing to the philanthropic sector sooner, as their donation is not contingent on a liquidity event occurring years later (e.g. an acquisition or Initial Public Offering of the company they founded); and
- Contributing an asset with significant growth potential.

As part of this submission, we have commented on Treasury's specific consultation question below.

15. Are there other improvements that could be made to the operation of the ancillary fund guidelines

Background

- Australia has experienced an unprecedented tech boom in the last ten years, creating around 100 tech companies valued at over \$100 million, of which 67 were formed in the last ten years.¹
- In our view, there is untapped potential among donors in these companies who have the capacity to establish PAFs and make a significant contribution to the Australian philanthropic sector. Whilst StartUpGiving is supportive of a PAF structure as they provide these individuals with an investment structure to provide ongoing long-term support to charities, we have identified some tax law impediments that can make setting up a PAF difficult and may be limiting the potential to encourage greater philanthropy in the innovation sector.
- Tech companies are generally funded by the company's founders, friends, and family members at the 'seed' stage before progressing to growing the business through external funding from angel investors, institutional investors and venture capital firms in the form of Series A, Series B and Series C funding rounds. Tech startups that progress to Series B or Series C Funding are generally doing well and are ready to expand into new markets.
- We anticipate that a donor would not consider establishing a PAF until they are in a position to donate shares with a value of at least \$1 million. At this point in time, the company is likely to be valued at \$100 million+ of which they are likely to hold shares in the company with a value of at least \$20 million.
- It is important to note that while donors hold equity and are wealthy on paper, all available capital is generally invested in their business. Therefore, they are generally 'cash poor' with a low taxable income until such time as they exit the business (selling their shares for cash) or undertake an Initial Public Offering **and therefore these donors will principally be gifting shares in their unlisted startup to a PAF.**

¹<https://techcouncil.com.au/wp-content/uploads/2021/10/2021-October-Roadmap-to-Deliver-One-Million-Jobs.pdf>

Issues

- Under the current Australian Taxation Office (**ATO**) administration process, donors who are gifting unlisted shares over \$5,000 (which is the scenario that the founders we speak to will be in) are required to have gifted their shares to the PAF before the ATO undertakes the valuation and when they can claim a deduction on their tax return. The impact of this arrangement is that:
 - There may be a mismatch between the market valuation of the shares and the ATO's valuation (i.e. institutional investors may value the shares at \$1 million, while the ATO may value the shares at say \$900,000).
 - From a tax position, this means that the donor can only claim a \$900,000 tax deduction instead of a \$1 million deduction based on the donor's value of assets given up. Additionally, there would be limited avenues available to them to resolve this with the ATO efficiently, and they would be in a situation where they have already transferred legal title to the shares without the ability to retrospectively unwind the transaction.
 - Existing investors of the tech startup may have concerns about the valuation discrepancy arising from the work of valuers instructed by the ATO.
- Further compounding this issue is the fact that the shares are in unlisted tech startup companies such that their price or value is not referable to any stock exchange or listed market.

Policy suggestion for consideration

- Valuing an unlisted tech startup company that has previously raised funds from institutional venture capital investors (i.e. when donors are likely to start thinking about gifting their shares to a PAF) is complex and not just a function of their profit. Generally their valuation is based on a combination of:
 - Revenue;
 - Revenue growth;
 - Customer churn rate;
 - Total Addressable Market;
 - Unit Economics (how much does it cost to acquire and service the customer relative to the price the customer has paid for the product/service); and
 - Market sentiment.
- Institutional Venture Capital (as well as Growth Capital, Private Equity and Superannuation) Funds undertake significant diligence in determining the valuation of a tech startup that they are

considering investing in. Given these funds must provide competitive returns to their investors it is reasonable to conclude that they apply sufficient rigour to the valuation process.

- When a donor gifts shares in their tech startup to a PAF, the only valuation that has been tested with rigour is the valuation of the tech startup at the last institutionally led funding round.
- Given most tech startups undertake funding rounds every 24 to 36 months, an appropriate valuation methodology should be to allow PAFs to use the last institutional funding round as the basis for valuing their shares in the PAF, for a period of three years.
- If this approach is adopted with appropriate legislation and/or guidelines, then the ATO as administrator has a well documented valuation methodology applied for both the initial donation (which is likely to be at least 6 months after a funding round) and the annual PAF valuation (which is required under paragraph 16 of the [Taxation Administration \(Private Ancillary Fund\) Guidelines 2019 \(PAF Guidelines\)](#)).
- Once three years have passed, then an external review could be undertaken.
- Further if the last funding round was a “down round” (i.e. the tech startup shares, and therefore the shares in the PAF were valued by external investors at a lower amount on a per share basis compared with previous funding rounds), then the ATO could request a further review and discussion on the appropriate valuation methodology to apply from that time onwards.
- In summary the general policy reform proposition would be that:
 - As long as the last funding round for a tech startup was no more than three years ago; and
 - The last round was led by well regarded, scaled institutional investors (i.e. a transaction involving a fully informed willing buyer and a willing seller); and
 - The valuation of the tech startup is at least the same as the previous institutional led funding round,

then the valuation of the shares in the PAF can be based on the value set from the most recent funding round.

Concluding remarks

- It is imperative that certainty is available for the valuation process prior to the legal transfer of the shares to the PAF. Resolving this aspect clarifies the donor's tax implications as it relates to gifting shares to the PAF.
- It is our view that the reform proposal above would encourage donors to start contributing to the charitable sector earlier (rather than waiting for a liquidity event to happen) and ensure their focus is on philanthropy rather than being faced with an administrative burden of having to challenge valuation discrepancies.
- By gifting shares (rather than cash), donors are contributing an asset to the philanthropic sector that has significant growth potential and is intended to provide increased support to charities in the future.
- A number of other matters warrant further consideration beyond the initial donation of unlisted shares into a PAF, and these include
 - The appropriate circumstances and mechanism that could make it possible to reduce the annual distribution percentage in the early years following the set-up of PAF's holding unlisted shares (i.e. in the second and third years), which could be accompanied with undertakings to make catch up contributions in the future;
 - The circumstances in which it is appropriate to allow transactions between the PAF and the donors/founders (or their associates) in order to meet annual distribution requirements from the PAF; and
 - The investment strategy approval for PAFs holding unlisted shares in these circumstances.

Thank you for providing us with the opportunity to participate in the Treasury consultation process.

Antonia Ruffell
Chief Executive Officer
StartUpGiving

Email: antonia@startupgiving.com.au
Mobile: 0401 550 321

Daniel Petre AO
Founder/Chair
StartUpGiving

Email: dpetre59@gmail.com
Mobile: 0412 345 591