

Director
Investment Funds Unit
Retirement, Advise and Investment Division
The Treasury
Langton Crescent
Parkes ACT 2600

Angel Loop Ltd

RE: Submission on Review of the regulatory framework for managed investment schemes.

Angel Loop broadly speaking, supports treasury's approach to wholesale client threshold changes with several suggestions to professionalise and drive greater adoption of early-stage investment. Angel Loop is solely concerned with Chapter 1 of the consultation paper.

Background

Angel Loop is a not-for-profit acting in the best interest of the public and believes there needs to be greater professionalism of early-stage investment to encourage greater participation.

Angel Loop Ltd ATF Angel Loop Charitable Trust (ALCT) is a registered charitable institution in Queensland for the promotion of a culture of Innovation and Entrepreneurship in Australia. Innovation charities fall within the "Advancing Commerce" charitable classification. As required by section 6 of the Charities Act 2013 the achievement of the purpose must be for the Public Benefit in "that innovative ideas generally be carried through to successful commercial fruition" ¹ "which is not only beneficial to the public generally but also a direct benefit to a section of the public, being those members of the public with the inclination and ability to make inventions for commercial purposes and invest in them" ².

Angel Loop has previously applied and been denied ACNC endorsement. The Administrative Appeals Tribunal primary based their judgement on an interpretation of the definition of the achievement of the public benefit of Innovation as the "achievement" was never defined in the original test case.

The tribunal declared:

"The Applicant goes further than encouragement ("achievement"). Part of its essential activities is obviously to bring about an arrangement between an inventor (sic) and an entrepreneur(s). Its core function is not simply to educate and encourage or assist. A core function is to bring about a commercial deal between investor and inventor." ³

¹ The Commissioner of Taxation v The Triton Foundation [2005] FCA 1319 [26,7]

² Ibid [36]

³ <https://www.acnc.gov.au/tools/guidance/decision-impact-statements/acnc-decision-impact-statement-angel-loop-ltd>

In short according to expert interpretation of the decision “any benefit to the investor as an unsought consequence of helping the inventor”⁴

It is important to note with the section 360 ITAA 1997 Explanatory Memorandum (EM) clearly explains the achievement of the public benefit:⁵

“1.5 The National Innovation and Science Agenda (NISA) contains complementary measures to ensure innovative companies are supported at different stages of development, by aligning our tax system and business laws with a culture of entrepreneurship and innovation. The Australian Government seeks to encourage innovation through a tax system that encourages an entrepreneurial and risk taking culture.

1.6 The tax incentive for early stage investors (TIFESI) is designed to promote this culture by connecting relevant start-up companies with investors that have both the requisite funds and business experience to assist entrepreneurs in developing successful innovative companies, particularly at the pre-commercialisation phase where a concept is in development, but the company requires additional investment to assist with commercialisation.

1.7 Often it is the high risk period between initial funding to the time a start-up company begins generating revenue that makes it difficult to attract investors or obtain finance to develop a concept past initial funding. In fact, this stage is sometimes described as a ‘valley of death’ where most start-up companies fail simply because they find themselves vulnerable to cash flow requirements.”

Furthermore, in Scott Morrison’s second speech on the bill.⁶

“Within the early stages of an innovation company's financing life cycle, difficulty attracting funding can prevent entrepreneurs from developing and commercialising their ideas. In fact, this stage is sometimes described as the 'valley of death' where many start-ups find themselves unable to meet their cash flow requirements. It is important that the government help connect business expertise with entrepreneurs so that innovative ideas can reach the market through commercialisation.”

Angel Loop wishes to highlight the discrepancy between how ACNC, ASIC and ATO recognise the achievement of the public benefit of Innovation. Where the ATO gives a 20% Tax offset to retail clients who invest \$50,000/year into early-stage companies⁷ ASIC making it illegal without a AFS license for anyone to introduce them.⁸ (Angel Loop has been granted an exemption for Sophisticated Investors)

Angel Loop believes strongly in the ATO position, and that Angel Investment is for the public benefit and is ancillary (conferred as a necessary means⁹) to bringing more Innovations to successful commercial fruition. All "members of the public with the inclination and ability to make investments"¹⁰ need to be provided with a pathway to participate. " Equally so that the public generally may enjoy

⁴https://eprints.gut.edu.au/214123/1/2021_119_Angel_Loop_Ltd_v_Commissioner_of_the_Australian_Charity_and_Not_for_profits_Commission_2021_AATA.pdf

⁵ TAX LAWS AMENDMENT (TAX INCENTIVES FOR INNOVATION) BILL 2016 EM

⁶ TAX LAWS AMENDMENT (TAX INCENTIVES FOR INNOVATION) BILL 2016 Second Speech

⁷ INCOME TAX ASSESSMENT ACT 1997 - s360.20

⁸ <https://asic.gov.au/regulatory-resources/find-a-document/regulatory-guides/rg-129-business-introduction-or-matching-services/>

⁹ Charities Bill 2013 EM 1.70

¹⁰ The Commissioner of Taxation v The Triton Foundation [2005] FCA 1319 [36]

the benefits that the ready availability of new and improved products may bring to increase their material well-being.”¹¹

Answers to Questions

Chapter 1 – Wholesale client thresholds

Question 1 Financial Threshold for the product value test be increased?

Angel Loop has no position with respect to this question.

Question 2 Financial Threshold for net assets and/or gross Income be increased?

Angel Loop agrees that the threshold should be increased on the condition that the public are provided with greater clarity on educational pathways towards Sophisticated Status.

Angel Loop believes to classify early-stage investment as a common “well understood” asset class is highly dubious. From historical records, only 35% of invested businesses will make ANY return. While technically it is classed as a financial investment¹² and sophisticated investors “by wealth” are free to partake, however from experience the likelihood of them making a return without suitable experience (regardless of wealth) is very slim.

Angel Loop strongly disagrees with other for-profit entities claim that “Angels” or early-stage investors should continue to use the “wealth” loophole that takes advantage of uneducated wealthy investors by not fully informing them of the (not so common knowledge) risks associated with the asset class.

Angel Loop believes all Early-stage Investors should be treated as retail clients unless they can objectively demonstrate financial literacy.

Angel Loop agrees with Treasury’s conclusion on the use of s761GA:

“Arguably the approach to defining “sophisticated investors” in sections s761GA and s708(10) is a more appropriate way to distinguish whether are able to deal with complex financial products than a simple wealth test. Although the subjective nature of the ‘sophisticated investor’ places the onus on the licensee, creates less certainty and makes it difficult to determine if a certificate was properly issued.”¹³

Angel Loop supports greater public professional training courses for early-stage investors.

Angel Loop believes that all Angel Investors should undertake “Professional Training”¹⁴ to ensure that they truly understand the associated risks (as required under s761GA and s708(10)). Angel Loop has for the past two years conducted a national “professional training” program for Angel Investors

¹¹ Ibid [26,7]

¹² Corporations Act 2001 s763(a)ii

¹³ Wholesale and Retail Clients Future of Financial Advise 2011

¹⁴ CORPORATIONS LEGISLATION AMENDMENT (SIMPLER REGULATORY SYSTEM) BILL 2007 1.18

in conjunction with UQ Ventures.¹⁵ This public course has been run around Australia and with the support of several Not-For-Profit Angel Groups under the Angels Australia banner.¹⁶

Angel Loop supports certifying public professional training courses for early-stage investors.

Angel Loop also agrees that the subjective nature of s761GA in placing onus on the licensee creates less certainty for AFS Licensees to know whether to accept retail investors based on experience. While the purpose of the course is to provide objective evidence, from experience many AFS Licensees “would not risk their license” or showed concerns with their ability to obtain insurance. Angel Loop requests that public professional training courses be approved or certified. This will go a long way to create certainty and clarity in the market and drive broader acceptance of the use of s761GA/s708(10) as a pathway to sophisticated status.

Angel Loop supports increasing the threshold to \$4.5M/\$450k on the condition that there is more clarity and certainly in the use of s761GA/s708(10) pathways with respect to early-stage investors.

Question 3: Should certain assets be excluded from determining an individual’s net worth.

Angel Loop has no position with respect to this question.

Question 4: If consent requirements were to be introduced:

(a) How would it be best designed.

Angel Loop currently provides a common consent system for both s761G(7)c and s761GA sophisticated investors for all its supported Angel Groups. It forms part of our “Qualified Early-stage Investor” or QEI program.¹⁷

Angel Loop issues a QEI Certificate which is in effect acts as a private “sophisticated investor certificate”. Angel Loop uses it as a written statement under s761GA(e) or a confirmation of a valid Accountants certificate under s761G(7)c). The certificate is renewed and reissued annually to ensure literacy activity and currency of the accountant’s wealth certificate.

Angel Loop recommends that under s761GA, that the provider of the written statement or “Sophisticated Certificate” (s761GA(e)) is permitted to be different to the provider of the consent (s761GA(f)) and to formally recognise a “Sophisticated Certificate” from an approved issuer.

Many early-stage Investors use several providers and are required to verify sophisticated status to each provider separately. To cultivate greater investor professionalism, improve clarity, reduce complexity and drive adoption, Angel Loop recommends that a central benevolent provider issue a “Sophisticated Certificate” (to attest to Sophisticated Status) like Angel Loop’s QEI for a prescribed asset class. In this way, other providers in that class may utilise that certificate to provide clarity and are only required to issue the consent to partake in an investment opportunity (on a case-by-case basis).

¹⁵ <https://ventures.uq.edu.au/qualified-early-stage-investor-course>

¹⁶ <https://angels.org.au/>

¹⁷ <https://angels.org.au/qualification>

(b) Should the same consent requirements be introduced for each wholesale client test?

Yes with conditions.

Angel Loop recommends that the consent form content be harmonised for s761G(7)c and s761GA.

Angel Loop has already extends the consent requirement under s761GA(f) to include s761G(7)c so that it forms part of a common consent process. All investors are required to sign the same DocuSign consent document as part of the offer process. The process is seamless and effective. Having different wording for each wholesale client class creates unnecessary duplication.

Regards



Simon Horne
CEO
Angel Loop Ltd (ACN 618 764 202)
simon@angelloop.org