Treasury Consultation Paper – Tax Incentives for Early Stage Investors

CapitalPitch applauds the Government support of early stage companies. We believe that with the ending of the commodities boom, innovation style companies are the future for Australia and should continue to increasingly become a focal point of policy, regulation and taxation reform.

As a general note the paper refers to an "innovation company" as the target for this incentive scheme. There are many examples of large established companies that are "innovative", so we would suggest that a more appropriate term would be "early stage innovation company".

Definition:
We believe that setting a hard 3 year limit will unintentionally exclude many early stage innovation style companies that have taken longer periods to develop their products and services to the stage for investment. Companies may also try and circumvent these limits via corporate structuring such as closing and re-establishing, reverse takeovers, etc.

Unnecessary resources will then be spent by the government and/or departments trying to check and stop these actions. Questions will arise about what is acceptable behaviour or not, again wasting precious resources.

We believe the income, expenditure and non-listed criteria will satisfy the overarching aim of the definition of an early stage innovation company.

Exclusions:
We believe that adding exclusions at this stage is unnecessary. The suggested list would create confusion and item 2., 5. & 13. Are particularly concerning potentially capturing companies within the disruptive fintech space for example.

The aim should be to have a clear definition of an early stage innovation company so that you don't need to add extra bureaucracy via an exclusion list.

As a general note, we believe that any system that defines what companies are included should meet the following objectives:

- Simple to understand
- Simple and quick to administer/qualify (assuming a company should qualify)
- Ability to qualify before investors invest (they will want certainty that the companies qualify)

Direct Investment:
The qualification should not be restricted to only sophisticated investors. Our rationale for this is:

- It risks the government's plan being labelled as a tax break just for the rich
- It restricts the vast majority of potential investors
- It adds another qualifying burden (accountant sign off)
- It would kill potential equity crowdfunding

At CapitalPitch we always encourage businesses to seek investment from sophisticated investors, as we believe they add more strategic value to a business, are better qualified to assess the investment and managing potentially hundreds of retail investors is often difficult for small

businesses. That being said if a business wishes to pursue retail investors (within the current or future regulatory framework) we do not think that it is fair that sophisticated investors should be given special tax treatment.

Indirect Investment:
We agree that the tax incentive should include indirect investment options too. However, we do not believe that it should be restricted to a company and the other restrictions listed in the consultation paper.

We think the qualifying criteria should be based on the destination of the investment (i.e. an early stage innovation company) not the source of the investment (sophisticated or company etc). The source should be irrelevant.

If the objective is to encourage investment in early stage innovation style businesses, then surely the source of the investment is irrelevant. To restrict the source would only limit the benefit of the scheme and distort the market.

CGT 3 Year Minimum Holding Period
We do not believe there should be any minimum holding period for the CGT discount to qualify. High velocity of early stage investment is better than slower velocity. If an angel investor, for example, can double their money in twelve months and reinvest their original amount and profits into two new early stage innovation companies, this will encourage faster economic growth.

With this in mind there are two major trends that are relevant to this velocity fact:

1. Investors are increasingly focusing on a particular stage of investment, rather than acting as next stage investors. This means that angel investors, for example, will only invest at the seed stage and not in the Series A round. VCs investing in the Series A or B round may offer early stage investors an exit, via a secondary sale.
2. Secondary sales are becoming more and more popular. This is a trend that is only likely to continue. A time based restriction would impact this trend and negatively impact the desire of investors to realise their profits and reinvest them into new businesses.

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