Attn: Office of Industry Innovation and Science Australia
Venture Capital Tax Concessions Review
Department of Industry, Science, Energy and Resources

Dear Directors,

Thank you for the opportunity to respond to the Venture Capital Tax Concessions review. The experience of Technology Council of Australia (TCA) members is that the programs covered by the terms of reference are key drivers of growth for the tech sector of Australia. Our submission summarises the positive impact the programs have had in helping to support and scale Australian tech sector investment and firms, and suggests opportunities for minor changes to the schemes to improve their effectiveness.

Overview of the TCA and role of venture capital funding in the Australian tech sector

The TCA is Australia's peak industry body for the tech sector. The Australian tech sector is a pillar of the Australian economy, contributing $167 billion per annum to the Australian economy, and employing 861,000 people. This makes the tech sector equivalent to Australia's third largest industry, behind mining and banking, and Australia's seventh largest employing sector.

Venture capital (VC) is critical to the success of Australia's tech sector because the finance it provides allows new and scaling firms to grow. Access to this finance is particularly critical for early stage firms.

TCA recommendations

1. Maintain the venture capital tax concession programs, particularly the ESVCLP. These tax concessions have been extremely effective at growing the pool of investment available for early stage Australian companies, and via this investment, increasing the number of tech firms that scale in Australia, and therefore the number of jobs created.
2. Make four minor amendments to ESVCLP scheme's administration to improve its efficiency and effectiveness, including:
    a. Adjusting the eligibility requirements under the ESVCLP rules, in consultation with industry, to better deal with a reasonable change in circumstance of an early stage company (e.g. a change in their business model) which can lead to the activity quickly becoming ineligible under the current scheme rules.
    b. Clarifying the capital account treatment capital gains on investment returns from an investee company that exceeds the $250M total assets threshold to provide greater investor certainty.

c. Amending the approach to investee company valuation to be based on the total asset value of a company, according to the total asset value in the company's balance sheet or unaudited accounts.
d. Clarifying holding company requirements to allow for other countries to be included in the list of permitted holding company locations (e.g. adding Singapore), and to allow for subsidiaries to be based in other jurisdictions.
e. Introducing a definition of an experienced investor to enable more Australlians to invest via programs such as the ESVCLP, even where they do not meet the current income and asset test for a sophisticated investor.. The industry would be pleased to work with the government on an approach that expands access to these schemes, while maintaining appropriate responsible investment measures appropriate to the risk profile of early stage companies.

The first section of our submission explains the positive impact VC tax concessions have had on early stage company investment, growth and jobs in Australia, and therefore why we recommend the current settings are maintained.

The second section recommends five minor amendments to the operation of the ESVCLP scheme that would improve its operation and increase investor certainty.

Section one: Impact of VC tax incentives programs and case for maining current approaches

The introduction of venture capital tax concessions has made a material and positive difference to creating and growing Australian tech sector firms. Just three years ago, Australia had a sole unicorn company, Canva (a unicorn is a tech sector firm valued at $1 billion or greater). Today, over a dozen companies are now considered Australian home-grown unicorns, with a strong pipeline of at least 99 companies with valuations of $100 million or more created in the last 5 years.[1] Further, the number of companies being created in each of the last three decades is increasing rapidly, as Table 1 below shows.

[1] Australian tech companies valued at $100M+ | by AirTree | AirTree | Aug, 2021 | Medium.com

Table 1: No. of Australian tech firms founded per decade with current valuation of $100m+

Decade of company formation	Current no. of companies founded in that decade presently valued at $100m+	Example companies
2000s	24	Domain, iSelect, Atlassian, Tyro, Health Engine, Finder, Red Bubble, Campaign Monitor, Envato, Hotels Combined, InfoTrack
2010s	67	Canva, Culture Amp, Safety Culture, Skedulo, Airwallex, Deputy, Brighte, 99designs, Airtasker, Koala, Stake, Prospa, Compass, Sendle, Freelancer, Flare, Afterpay, Judo Bank, Shippit
Total	91	

Source: Airtree

Unsurprisingly, in a similar timeframe there has been a noticeable growth in VC financing in Australia. From 2015 to mid-2018, Australian venture capital firms raised more than $4 billion in new funds, with the yearly value of new funds closed roughly doubling each year over that period.

Between 2015 and 2019, a total of 824 VC deals have been completed for Australian start-up companies, for an aggregate value of $7.2bn. This is up from an average of $0.24 billion in the preceding 5 years.

In the period from 2015-2019, the average size of a substantial growth round (Series A and beyond raising US$2 million or more) had grown steadily, from an average of US$9.73 million in 2015, to US$18.89 million in 2019, indicating a direct correlation between the amount of money in the Australian VC landscape, and firm success in raising capital.

Positive impact of ESVCLPs on Australian tech sector investment, firms and jobs

TCA member experience is that the Early Stage Venture Capital Limited Partnerships (ESVCLP) program in particular has been highly successful at catalysing early stage company funds, which is supporting the additional investment outlined above, and through it, company growth and job creation.

TCA members alone manage 10 ESVCLP funds, which have raised over $1.4bn across their lifespan. Most growth in these funds occurred in the last 3-5 years. These 10 funds have enabled over 800 companies to receive critical early stage funding. Each of these 800 companies have on average gone on to employ 70 staff.

Prior to the creation of the ESVCLP program, these early stage companies did not have an obvious option to access capital. We therefore strongly recommend maintaining the ESVCLP program to encourage further investment in early stage companies, and to streamline the process for companies to find the right fund and funding for them.

Impact of ESVCLP on the Australian investment landscape

The ESVCLP program has also had three positive and measurable impacts on early stage company investment in Australia.

1. **Encouraged risk taking**

The ESVCLP program has increased investment in early stage companies by mitigating e risks associated with early-stage investment and incentivising new kinds of investors to participate.

Of the funds represented by our membership, close to 200 new investors have joined ESVCLP funds in the last three years. A further 1,500 investors have chosen to contribute to ESVCLP funds or switched from other kinds of funds. This suggests there is appetite to participate and grow early-stage funding in Australia, and that the program is addressing a market gap.

Transparent reporting on available partnerships has also helped improve matching of investors and investee companies.. It has streamlined the process for start-ups to identify which funds would best suit their business. It has allowed prospective investors to identify which fund manager is best aligned with their interests and investment priorities..

Across the funds managed by TCA member companies, there has been an increase in the average amount of capital being granted to early-stage companies, as well as the value of capital raised. This is evidence the program is increasing the number of “shots on goal” companies receiving funding (that is, firms which have a serious prospect of attracting investment and scaling), increasing confidence in early-stage investment in Australia.

2. **Creating jobs**

The introduction of the VC tax concession programs has had a positive impact on jobs and economic growth in Australia. Over the last 5 years, funds managed by member firms of the TCA have contributed to the creation of over 15,000 jobs. Companies funded through ESVCLP funds managed by TCA members on average employ 70 Australians. Average employment by companies has also increased as the size of funding rounds has grown.

These jobs are coming in multiple industries, as tech firms operate across sectors. Companies funded by ESVCLPs run by TCA members operate in areas including: Consumer, E-Commerce, Internet of Things, Marketplace, SaaS, Hardware, Mobile, Software, Space, Alternative Protein, Application, BioComputers, Clean Meat, Cybersecurity, Developer Tools, Energy, Fintech, Gaming, Health, Legal Services, Payments, Robotics, Solar, Transport.

Tech sector job creation activity is an important source of employment growth in Australia. Since 2005, tech related jobs have grown by 55 percent, compared with an average of 35 percent for jobs across the economy. Today, 861,000 people are employed in tech jobs in Australia, with a software engineer and developer a more common job than plumber, solicitor or hairdresser. In the last year of the pandemic, 65,000 tech-related jobs were created, making tech sector jobs second only to retail jobs as the fastest growing source of employment in the economy.

Recognising the important job creation role the tech sector plays in Australia, the TCA has set a goal of employing 1 million people in tech-related jobs in Australia by 2025. We regard the continuation of the venture capital tax concession programs as an important element in achieving that job creation target.

3. **Encouraged growth of the VC ecosystem in Aus**

The ESVCLP program has supported the growth of Australia's VC ecosystem by providing an easy way for new investors to come together, and expanding the value of funds raised.

It has also broadened the diversity of funds, and investment opportunities. For example, Taronga Ventures is an ESVCLP owned by a number of high profile global real estate and built environment companies. Taronga Ventures invests in emerging innovation, technology and business models shaping the future of the built environment. They offer direct venture investment, as well as programs and advisory services to support the growth of our portfolio companies and their impact on the traditional real estate sector.

The ESVCLP programme has enabled these companies to easily come together to drive investment that will help encourage and promote innovation within their industry, increasing the VC ecosystem in Australia. Increasing the ease of access to

Opportunities for optimisation of venture capital tax incentives

The current venture capital tax incentive programs are working well. Our primary recommendation is to maintain them in their current form. However, we recommend making five minor amendments to the current model to optimise its impact.

1. **Eligibility review**

It is not unusual for an eligible investment to no longer meet eligibility requirements under the ESVCLP rules shortly after the initial date of assessment and investment. This may occur where a company pivots its business model or expands into an area that is ineligible under the ESVCLP regulations. These are both regular occurrences for early stage companies. Where this occurs, the ineligible investment is required to be transferred out of the ESVCLP within a prescribed time period. If this is not achieved, the regulators can deregister the ESVCLP.

This creates a number of issues due to the forced transfer or sale of the investment, including:

- Investment is sold far below market value at fire sale prices as it may not be the right time to sell the asset;
- The investors who have supported the investee company may want to continue to hold the asset to realise the growth potential but are forced to sell and;
- The investee company has selected the fund manager for strategic and commercial reasons and may lose a key investor as a result of the ESVCLP regulations

We therefore recommend adjusting the eligibility requirements definition, in consultation with industry, to better deal with a reasonable change in circumstance that currently has the effect of revoking eligibility under the scheme.

2. **Capital Account Treatment of Investments after $250M Total Assets:**

Once an investee company crosses $250M in total assets, the capital gains treatment of any investment returns after that point is not clearly defined in the ESVCLP regime. This creates uncertainty for ESVCLP fund managers and underlying investors.

We recommend clarifying the capital account treatment capital gains on investment returns from an investee company that exceeds the $250M total assets threshold to provide greater investor certainty. This is consistent with the approach taken to Managed Investment Trusts, another common vehicle used by fund managers.

3. Total assets used for Entity Value on Statutory Declarations before an auditor is required

The ESVCLP requires Directors to make a statutory declaration about the value of a company's assets when investing in a new company via an ESVCLP. Directors must also make an annual statutory declaration when a company has less than A$12.5M of assets. Because of the fast-growing nature of early-stage companies, making precise valuations can be challenging, and may also be subject to rapid change.

We therefore recommend amending the approach to investee company valuation to be based on the total asset value of a company, according to the total asset value in the company's balance sheet or unaudited accounts.

4. Holding Company Definition

Australian start-ups frequently use a corporate structure with a main operating company based in Australia, and a holding company set-up in a second country (commonly the US). This helps maximise the pools of venture capital and other sources of funding the company can access.

The ESVCLP program wording currently states that the investee company's Holding Company must be based in a restricted list of countries and cannot carry on any business other than to support the primary activity of the Australian operating subsidiary company.

This creates complexities, especially when companies begin the crucial scaling phase of their lifecycle and grow their operations to jurisdictions beyond just Australia and the location of the holding company.

We recommend clarifying this requirement to allow for other countries to be included in the list of holding company locations (e.g. Singapore), and to allow for subsidiaries to be based in other jurisdictions.

5. Expanding investment opportunities to more Australians

Currently, only people that meet the definition of a sophisticated investor are eligible to participate in ESVCLP schemes. To qualify as a sophisticated investor, a person must meet an income and asset test. This restricts access to tax concessions for investment in early stage firms to very wealthy Australians.

There are many individuals with the experience and desire to invest in early stage companies that do not meet the asset and income test. This includes women, who may have taken career breaks to raise children, and younger Australians working in the sector who have not yet had the opportunity to acquire substantial assets.

We recommend that the government introduces a definition of an experienced investor to enable more Australlians to invest via programs such as the ESVCLP, even where they do not meet the current income and asset test. The industry would be pleased to work with the government on an approach that expands access to these schemes, while maintaining appropriate responsible investment measures appropriate to the risk profile of early stage companies.

Conclusion

The TCA welcomes the review of the VC tax concession programs, which have been a critical part of the growing tech sector in Australia. The ESVCLP program in particular has enabled the growth of some of the most prominent companies in Australia's start-up and technology scene and will continue to do so while the incentives exist. We commend the federal government for introducing these measures, and support their continuation.

Thank you for the opportunity to contribute to this review.

Yours sincerely,

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